

**\$771,274,288.85**

**Puerto Rico Public Finance Corporation**  
**2001 Series C Bonds**  
**(Commonwealth Appropriation Bonds)**

Puerto Rico Public Finance Corporation (the "Corporation") is issuing its 2001 Series C Bonds (the "2001 Series C Bonds") to fund, together with the proceeds of the Corporation's 2001 Series D Bonds and 2001 Series E Bonds (collectively, the "Series 2001 Bonds"), the purchase of certain promissory notes (the "Notes") issued in connection with the restructuring of certain outstanding loans made by Government Development Bank for Puerto Rico ("Government Development Bank") to certain departments, agencies, instrumentalities and public corporations of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico").

The Series 2001 Bonds are limited obligations of the Corporation payable solely from payments of principal of and interest on the Notes. The Notes are payable solely from budgetary appropriations to be made pursuant to legislation approved by the Legislature of Puerto Rico, signed by the Governor and presently pending its official publication (the "Act"). The Act requires the Office of Management and Budget to include in the operating budget of the Commonwealth submitted annually to the Legislature of the Commonwealth an amount not to exceed \$225 million to be used to pay the principal of and interest on the Notes and any loans covered by the Act which are held by Government Development Bank as they become due and payable. If the budgetary appropriations provided for under the Act are made on a timely basis each year and in the required amounts, payments required to be made under the Notes will at all times be sufficient to pay the principal of and interest on the Series 2001 Bonds as they become due and payable. The Legislature of Puerto Rico is not legally bound to appropriate funds for such payments.

The 2001 Series C Bonds will have the following characteristics:

- Interest on the 2001 Series C Bonds, except capital appreciation bonds, will be payable monthly on the first day of each month, commencing on February 1, 2002. Interest on the capital appreciation bonds will compound semi-annually on each February 1 and August 1, commencing on February 1, 2002, and will be payable at maturity. Interest will accrue from the date of issuance of the 2001 Series C Bonds.
- The inside cover page contains information respecting the maturities, interest rates and prices or yields to maturity of the 2001 Series C Bonds.
- The 2001 Series C Bonds are subject to redemption as described in this Official Statement.
- Under most circumstances, interest on the 2001 Series C Bonds will be exempt from Puerto Rico and United States taxes to residents of Puerto Rico. Interest on the 2001 Series C Bonds is not excludable from gross income for federal income tax purposes under Section 103(a) of the United States Internal Revenue Code. See "Tax Matters" beginning on page 15 of this Official Statement.

The 2001 Series C Bonds are expected to be delivered on or about December 27, 2001.

**The 2001 Series C Bonds will not constitute an obligation of the Commonwealth or any of its political subdivisions or public instrumentalities (other than the Corporation), and neither the Commonwealth nor any of its political subdivisions or public instrumentalities (other than the Corporation) will be liable thereon. The Corporation has no taxing power.**

*Joint Lead Managers*

**Santander Securities**

**UBS PaineWebber Incorporated of Puerto Rico**

**Oriental Financial Services**

**BBVA Capital Markets**  
**Popular Securities**

**Doral Securities**  
**Prudential Securities Incorporated**

**Morgan Stanley**  
**Salomon Smith Barney**

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**\$122,535,000 Serial Bonds**

<b>Maturity Date</b>	<b>Principal Amount</b>	<b>Interest Rate</b>	<b>Price</b>
<u>August 1,</u>			
2003	\$19,070,000	4.00%	100%
2004	19,260,000	4.50	100%
2005	4,810,000	4.75	100%
2006	3,475,000	5.00	100%
2007	24,800,000	5.40	100%
2008	20,225,000	5.50	100%
2009	10,415,000	5.60	100%
2010	9,495,000	5.70	100%
2011	10,985,000	5.80	100%

**\$637,655,000 Term Bonds**

\$ 40,310,000 5.80% Term Bonds due August 1, 2011 -price 100%  
 \$106,665,000 6.05% Term Bonds due August 1, 2017 -price 100%  
 \$ 60,700,000 6.10% Term Bonds due August 1, 2021 -price 100%  
 \$429,980,000 6.15% Term Bonds due August 1, 2024 -price 100%†

**\$11,084,288.85 Capital Appreciation Bonds**

<b>Maturity Date</b>	<b>Initial Principal Amount</b>	<b>Yield to Maturity</b>
<u>August 1,</u>		
2012	\$2,542,051.80	6.05%
2013	2,011,675.60	6.05%
2014	2,119,504.50	6.05%
2015	1,563,225.95	6.05%
2016	1,426,695.00	6.05%
2017	1,421,136.00	6.05%

†Not reoffered

No dealer, broker, sales representative or other person has been authorized by the Corporation or the Underwriters to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the Corporation or the Underwriters. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the 2001 Series C Bonds by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. The delivery of this Official Statement at any time does not imply that the information contained herein is correct as of any time subsequent to its date. The information set forth herein has been obtained from the Corporation, the Commonwealth and other official sources that are believed to be reliable. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Corporation or the Commonwealth since the date hereof. The Underwriters have provided the following three sentences for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

**IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE 2001 SERIES C BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.**

There is currently no secondary market for the 2001 Series C Bonds and there can be no assurance that a secondary market will develop or, if it does develop, that it will provide holders of the 2001 Series C Bonds with liquidity for their investment or that it will continue for the life of the 2001 Series C Bonds.

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**INTRODUCTORY STATEMENT AND PLAN OF FINANCE**

This Official Statement of Puerto Rico Public Finance Corporation (the "Corporation"), a subsidiary of Government Development Bank for Puerto Rico ("Government Development Bank"), provides certain information in connection with the sale of Puerto Rico Public Finance Corporation 2001 Series C Bonds (the "2001 Series C Bonds").

This Official Statement incorporates by reference (i) the Comprehensive Annual Financial Report of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") for the Fiscal Year ended June 30, 2000, prepared by the Department of the Treasury of Puerto Rico (the "Commonwealth's Annual Financial Report"), which report includes the general purpose financial statements of the Commonwealth as of and for the Fiscal Year ended June 30, 2000, which have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report accompanying the financial statements; and (ii) the Commonwealth's Financial Information and Operating Data Report dated September 25, 2001 (the "Commonwealth Report"). The Commonwealth's Annual Financial Report has been filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR"). The Commonwealth Report is incorporated by reference from the Official Statement of the Commonwealth, dated October 11, 2001, relating to the issuance by the Commonwealth of its \$455,000,000 Public Improvement Bonds of 2002, Series A and its \$837,960,000 Public Improvement Refunding Bonds, Series 2002 A, which has been filed by the Commonwealth with each NRMSIR and with the Municipal Securities Rulemaking Board (the "MSRB"). Any appendix of an official statement of the Commonwealth or of any instrumentality of the Commonwealth containing the Commonwealth's Annual Financial Report or the Commonwealth Report filed with each NRMSIR and the MSRB or any other document containing the Commonwealth's Annual Financial Report or the Commonwealth Report filed with each NRMSIR after the date hereof and prior to the termination of the offering of the 2001 Series C Bonds shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained in any of the above described documents incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any subsequently filed document modifies or supersedes such statement. Any statement contained herein shall also be deemed to be modified or superseded to the extent that a statement contained in any subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

For information on how to obtain the Commonwealth's Annual Financial Report and the Commonwealth's Report, see "Miscellaneous."

The Commonwealth expects to complete the preparation of its Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2001, which will include the Commonwealth's general purpose financial statements as of and for the Fiscal Year ended June 30, 2001, together with the report thereon of the independent auditors, during the first calendar quarter of 2002. Upon completion thereof, the Commonwealth will file such Comprehensive Annual Financial Report with each NRMSIR and will make such report available to any person to whom this Official Statement is delivered upon request therefor in the manner specified below under "Miscellaneous".

The 2001 Series C Bonds are being issued under a trust agreement to be dated the date of issuance of the 2001 Series C Bonds (the "Trust Agreement"), between the Corporation and The Bank of New York, as trustee (the "Trustee").

Concurrently with the issuance of its 2001 Series C Bonds, the Corporation will issue under the Trust Agreement its 2001 Series D Bonds and will subsequently issue its 2001 Series E Bonds in the principal amounts of \$40,750,000 and \$1,095,845,000, respectively. The 2001 Series C Bonds, the 2001 Series D Bonds and the 2001 Series E Bonds (collectively, the "Series 2001 Bonds") are being issued for the purpose of providing the Corporation with the necessary funds to purchase from Government Development Bank several promissory notes (the "Series 2001 Notes") issued in connection with the restructuring and refinancing of certain loans made by Government Development Bank to certain departments, agencies, instrumentalities and public corporations of the Commonwealth (the "Authorized Debtors") pursuant to the terms of legislation approved by the Legislature of Puerto Rico, signed by the Governor of Puerto Rico and presently pending its official publication (the "Act"). All loans made by Government Development Bank to Authorized Debtors

which are covered by the Act are referred to herein as the "Loans." See "Source of Payment and Security for the Bonds - The Act, the Notes and the Loans." The 2001 Series D Bonds and 2001 Series E Bonds are being offered in separate Official Statements.

The Series 2001 Notes will evidence the indebtedness of those Authorized Debtors that, pursuant to the Act, will have restructured and refinanced their Loans with Government Development Bank as of the dates of delivery of the Series 2001 Bonds. Those Loans that are not restructured and refinanced with the Series 2001 Notes will continue to be held by Government Development Bank until additional bonds are issued by the Corporation under the Trust Agreement to fund the purchase of notes issued in connection with the restructuring of such Loans. As of June 30, 2001, the aggregate amount of principal and interest due on all Loans was approximately \$2.4 billion. The approved budget for Fiscal Year 2001-02 included an appropriation in respect of the Loans in the amount of approximately \$218 million. After this appropriation is applied to the payment of principal of and interest on the Loans, the aggregate principal due on all Loans will be approximately \$2.3 billion. Of this amount, approximately \$1.85 billion is being refinanced with the proceeds of the Series 2001 Bonds and the balance of approximately \$480 million will continue to be held by Government Development Bank.

The Series 2001 Bonds and any additional bonds issued in the future under the Trust Agreement are herein collectively referred to as the "Bonds". Additional Bonds may be issued under the Trust Agreement only to (i) fund the purchase of additional notes covered by the Act representing additional Loans that have been restructured and refinanced (such notes, together with the Series 2001 Notes, being referred to collectively as the "Notes"), (ii) refund any Bonds Outstanding under the Trust Agreement, (iii) fund a Reserve Account, if applicable, and (iv) pay the cost of issuance of such additional Bonds. See "Source of Payment and Security for the Bonds-Limitation on Additional Bonds."

The Bonds are limited obligations of the Corporation payable solely from Pledged Revenues (as defined in the Trust Agreement), consisting of payments of principal of and interest on the Notes and other amounts deposited to the credit of the Sinking Fund established under the Trust Agreement (the "Sinking Fund"), including the investment earnings therefrom. Payments of principal and interest under the Notes will be made solely from Legislative Appropriations to be made pursuant to the Act. The Act requires the Office of Management and Budget to include in the operating budget of the Commonwealth submitted annually to the Legislature of the Commonwealth the amounts necessary, up to a maximum of \$225 million per Fiscal Year, to pay the principal of and interest on the Notes and the Loans as they become due. If the Legislative Appropriations provided for under the Act are made on a timely basis each year and in the required amounts, payments of principal and interest required to be made under the Series 2001 Notes will at all times be sufficient to pay the principal of and interest on the Series 2001 Bonds as they become due and payable. The Legislature of Puerto Rico is not legally bound to appropriate funds for such payments. See "Source of Payment and Security for the Bonds."

This Official Statement, including information incorporated in this Official Statement by reference, contains certain "forward-looking statements" concerning the Commonwealth's operations and financial condition. These statements are based upon a number of assumptions and estimates which are subject to significant uncertainties, many of which are beyond the control of the Commonwealth. The words "may," "would," "could," "will," "expect," "anticipate," "believe," "intend," "plan," "estimate" and similar expressions are meant to identify these forward-looking statements. Actual results may differ materially from those expressed or implied by these forward-looking statements.

Descriptions of the Corporation, the Commonwealth, the 2001 Series C Bonds, the Trust Agreement and certain other documents are included in this Official Statement. Such descriptions do not purport to be comprehensive or definitive. All references herein to the Trust Agreement and other documents are qualified in their entirety by reference to each such document. References herein to the 2001 Series C Bonds are qualified in their entirety by reference to the forms thereof. The resolution of the Corporation authorizing the issuance of the 2001 Series C Bonds (the "Resolution") and each of the aforesaid documents are available for inspection at the offices of the Corporation, located at Minillas Government Center, De Diego Avenue, San Juan, Puerto Rico 00940.

Capitalized terms not otherwise defined herein are defined in the Trust Agreement. See Appendix I - "Summary of the Trust Agreement."

## USE OF PROCEEDS

The net proceeds of the 2001 Series C Bonds (after payment of the costs of issuance hereinafter described) will be used to purchase Series 2001 Notes at a price equal to the principal amount thereof plus accrued interest. A portion of the proceeds of the 2001 Series C Bonds will be applied to the payment of expenses incident to the issuance thereof. The sources and uses of bond proceeds are set forth below.

**Sources:**

Initial Principal Amount of the 2001 Series C Bonds .....	<u>\$771,274,288.85</u>
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**Uses:**

Purchase of Series 2001 Notes .....	\$733,448,239.96
Capitalized Interest on the 2001 Series C Bonds through August 1, 2002 .....	26,858,526.25
Underwriting discount, legal, printing and other costs of issuance .....	<u>10,967,522.64</u>
 Total Uses .....	 <u>\$771,274,288.85</u>

## PUERTO RICO PUBLIC FINANCE CORPORATION

The Corporation is a subsidiary corporation of Government Development Bank created pursuant to Resolution No. 5044 of the Board of Directors of Government Development Bank, as amended (“Resolution No. 5044”), adopted pursuant to the authority granted under Act No. 17 of the Legislature of Puerto Rico, approved September 23, 1948, as amended. The Corporation is exempt from the payment of any Commonwealth taxes on its revenues and properties and constitutes an independent governmental instrumentality of the Commonwealth separate and apart from Government Development Bank. The obligations of the Corporation are not obligations of Government Development Bank. For additional information regarding the Corporation and Government Development Bank, see “Public Corporations - Government Development Bank for Puerto Rico” in the Commonwealth Report.

The Board of Directors of the Corporation consists of the same members of the Board of Directors of Government Development Bank, who are the following:

<u>Member</u>	<u>Occupation</u>	<u>Expiration Date</u>
Juan Agosto Alicea, Chairman	President, Government Development Bank for Puerto Rico	September 22, 2004
Melba Acosta Febo	Director, Office of Management and Budget	September 22, 2002
Ramón Cantero-Frau	Secretary of Economic Development and Commerce	September 22, 2002
Juan A. Flores Galarza	Secretary of the Treasury	September 22, 2002
Samuel H. Jové Fontán	President, BMJ Foods of Puerto Rico, Inc.	September 22, 2003
Fermín Contreras Bordallo	Private investor	September 22, 2003
Carmen Conde Torres	Attorney at law	September 22, 2004

The following individuals are currently officers of the Corporation:

*Juan Agosto Alicea*, President, is also President of Government Development Bank, a position he assumed in January of 2001. Prior to joining Government Development Bank this year, Mr. Agosto Alicea held various positions in government and in the private sector. From 1985 to 1988 he served as Secretary of the Treasury of Puerto Rico, and was Chairman of the Board of Directors of Government Development Bank. From 1995 to 1996 he was Administrator of the

Municipality of San Juan. He worked for many years at two major accounting firms, and was the managing partner of one of these firms. He also worked at the Puerto Rico Industrial Development Company and the Federal Department of Housing and Urban Development. He obtained a bachelor's degree in accounting from the University of Puerto Rico and is licensed as a certified public accountant since 1966. He is a former president of the Puerto Rico College of Certified Public Accountants and the Board of Directors of United Way of Puerto Rico.

*José V. Pagán*, Executive Vice President, is also Executive Vice President of Government Development Bank, a position he assumed in January of 2001. Prior to joining Government Development Bank this year, Mr. Pagán held various positions in investment banking and accounting firms during a 17 year period. Mr. Pagán also held the position of Executive Vice President of the Government Development Bank during 1992. Mr. Pagán received a bachelor's degree in engineering and applied science from Yale University, and a master's degree in finance from the New York University Graduate School of Business Administration.

*Miriam Figueroa*, Executive Vice President and General Counsel, is also Executive Vice President and General Counsel of Government Development Bank, a position she assumed in January of 2001. Prior to joining Government Development Bank, Ms. Figueroa worked as an attorney in private practice in New York and Tokyo, and in the United States Congress. Ms. Figueroa received a bachelor's degree from Macalester College, a law degree from the Pontifical Catholic University of Puerto Rico, and a master of law degree from Harvard Law School.

*Olga L. Ortiz*, Secretary of the Board of Directors, is also Secretary of the Board of Directors of Government Development Bank.

Pursuant to Resolution No. 5044, the Corporation has the authority, among other things, to issue bonds and other obligations for borrowed money payable out of all or any part of funds received in payment of the principal of and interest on securities of governmental instrumentalities of Puerto Rico purchased by the Corporation or any other funds or assets of the Corporation as provided by the resolution or trust agreement authorizing the issuance of its bonds.

As of November 2, 2001, the Corporation had bonds or notes outstanding in the aggregate principal amount of \$1.9 billion. All such bonds and notes, other than the Bonds, are payable from revenues other than the Pledged Revenues. Except for bonds which may be issued in the future to refund the Bonds, to purchase additional Notes covered by the Act, to fund a Reserve Account for one or more series of Bonds or to fund the costs of issuance of Bonds, the Corporation may not issue additional bonds payable from Pledged Revenues. The Corporation may from time to time issue additional bonds, which would be authorized and issued pursuant to trust indentures or authorizing resolutions separate from and unrelated to the Resolution and the Trust Agreement and would be secured with revenues other than the Pledged Revenues. See Appendix I - "Summary of the Trust Agreement—Additional Bonds - Refunding Bonds."

## THE 2001 SERIES C BONDS

### General

The 2001 Series C Bonds are being issued as registered bonds without coupons and will be initially registered only in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC"), New York, New York, which will act as securities depository for the 2001 Series C Bonds. The 2001 Series C Bonds will be available to purchasers in denominations of \$5,000 principal amount or maturity amount (in the case of capital appreciation bonds) and any integral multiple thereof only under the book-entry system maintained by DTC through brokers and dealers who are, or act through, DTC Participants (as defined herein). Purchasers will not receive physical delivery of the 2001 Series C Bonds. So long as any purchaser is the Beneficial Owner (as defined herein) of a 2001 Series C Bonds, such purchaser must maintain an account with a broker or dealer who is, or acts through, a DTC Participant to receive payment of principal of and interest on such 2001 Series C Bonds. See "Book-Entry Only System" below.

The 2001 Series C Bonds are being issued pursuant to the Resolution and the Trust Agreement. The 2001 Series C Bonds will be issued in such aggregate principal amounts or initial principal amounts (in the case of capital appreciation bonds) and will be stated to mature as set forth on the inside cover page of this Official Statement.

Interest on the 2001 Series C Bonds will accrue from their date of issue at the rates set forth on the inside cover page of this Official Statement, and will be payable, except in the case of capital appreciation bonds, monthly on the first day of each month, commencing on February 1, 2002, until their respective maturities. Interest on the capital appreciation bonds will compound semi-annually on each February 1 and August 1, commencing on February 1, 2002, and will be payable at maturity.

Interest on the capital appreciation bonds will accrue from their date of issue. Such interest will be added to the accreted value of such bonds (which is initially equal to their initial principal amount) on the first day of each February 1 and August 1 (each a "Valuation Date"), and will be payable at maturity. Appendix V sets forth the accreted value of the capital appreciation bonds on each Valuation Date. On any date other than a Valuation Date, the accreted value of the capital appreciation bonds will be equal to the sum of (a) the accreted value on the preceding Valuation Date (or, if there is no preceding Valuation Date, the initial principal amount) and (b) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date (or from the original issue date if there is no preceding Valuation Date) and the denominator of which is the number of days from such preceding Valuation Date (or from the original issue date if there is no preceding Valuation Date) to the next succeeding Valuation Date and (2) the difference between the Accreted Values for such Valuation Dates (or between the initial principal amount and the Accreted Value on the first Valuation Date).

Interest will be calculated on the basis of a 360-day year of twelve 30-day months.

### **Optional Redemption**

At the option of the Corporation, and upon at least 30 days' notice, the 2001 Series C Bonds maturing on or after August 1, 2010, are subject to redemption, from any monies available for that purpose (other than from monies set aside with respect to an Amortization Requirement applicable to the Bonds), prior to maturity, in whole or in part, on any date not earlier than August 1, 2009, as directed by the Corporation, at the redemption prices (expressed as a percentage of principal amount or accreted value, in the case of the capital appreciation bonds) set forth in the table below, together with accrued interest to the dates fixed for redemption in the case of the serial and term bonds.

<b><u>Period During Which Redeemed</u></b>	<b><u>Redemption Price</u></b>
August 1, 2009 through July 31, 2010	102%
August 1, 2010 through July 31, 2011	101%
August 1, 2011 and thereafter	100%

### **Mandatory Redemption**

The Series C Bonds maturing on August 1, 2011, August 1, 2017, August 1, 2021 and August 1, 2024 (the "Series C Term Bonds"), are subject to redemption upon at least 30 days' notice, to the extent of their respective Amortization Requirements set forth below, commencing on August 1, 2008, August 1, 2010, August 1, 2018 and August 1, 2012, respectively, and on August 1 of each year thereafter, at a redemption price of par plus accrued interest to the dates fixed for redemption.

Amortization Requirements for the Series C Term Bonds means the principal amount fixed for the retirement by purchase or redemption of Series C Term Bonds in any Bond Year (the period from August 1 to July 31 of each year while the 2001 Series C Bonds are outstanding), as provided for in the Trust Agreement. The Amortization Requirement shall be the respective principal amounts for each Bond Year fixed in the Resolution (as set forth below) and the amount of the Amortization Requirement for each of the Series C Term Bonds shall be equal to the aggregate principal amount of such Series C Term Bond.

<u>August 1</u>	<u>Amortization Requirements for Series C Term Bonds</u>			
	<u>due August 1, 2011</u>	<u>due August 1, 2017</u>	<u>due August 1, 2021</u>	<u>due August 1, 2024</u>
2008	\$ 6,025,000			
2009	17,420,000			
2010	10,440,000	\$ 9,615,000		
2011	6,425,000*	13,985,000		
2012		11,470,000		
2013		12,480,000		\$16,890,000
2014		14,020,000		18,530,000
2015		15,370,000		18,490,000
2016		16,370,000		20,275,000
2017		13,355,000*		21,700,000
2018				26,975,000
2019			\$13,600,000	33,165,000
2020			14,700,000	35,105,000
2021			15,700,000	37,345,000
2022			16,700,000*	39,790,000
2023				60,170,000
2024				64,095,000
Average Life (in years)...	8.023	12.335	18.179	37,450,000*
				18.027

\*Maturity

If at the close of any Bond Year the total principal amount of the Series C Term Bonds retired by purchase or redemption or called for redemption under the provisions of the Trust Agreement during such Bond Year shall be in excess of the amount of the Amortization Requirement for such Bond Years, then the amount of the Amortization Requirement shall be reduced for such subsequent Bond Years in such amounts aggregating the amount of such excess as shall be determined by the President of the Corporation in an order filed with the Trustee on or before the 15<sup>th</sup> day of August following the close of such Bond Year.

#### Notice and Effect of Redemption

Any redemption of the 2001 Series C Bonds, either in whole or in part, shall be made upon at least 30 days' notice by mail to DTC or, if the book-entry only system as described below has been discontinued, by first class mail, postage prepaid, to all registered owners in the manner and under the terms and conditions provided in the Trust Agreement. On the date designated for redemption, notice having been given as provided in the Trust Agreement and monies for payment of the principal (or accreted value, in the case of capital appreciation bonds) of and redemption premium, if any, and the interest on the 2001 Series C Bonds or portions thereof so called for redemption being held by the Trustee, interest on the 2001 Series C Bonds or portions thereof so called for redemption shall cease to accrue. Subject to certain provisions of the Trust Agreement, 2001 Series C Bonds and portions thereof which have been duly called for redemption under the provisions of the Trust Agreement, or with respect to which irrevocable instructions to call for redemption or to pay at maturity have been given, and for which sufficient monies or investments permitted by the Trust Agreement are held in a separate account for the payment of the principal (or accreted value, in the case of capital appreciation bonds) of and redemption premium, if any, and the interest on the 2001 Series C Bonds or portions thereof to be paid or redeemed, such 2001 Series C Bonds shall not be deemed to be Outstanding under the Trust Agreement, and the registered owners thereof shall have no rights with respect thereto, except to receive payment of the principal (or accreted value, in the case of capital appreciation bonds) thereof and redemption premium, if any, and the interest therein from such separate account.

Each notice of redemption shall contain, among other things, the CUSIP identification number of the 2001 Series C Bonds (or portions thereof) being called for redemption, the redemption date and price and the address at which such 2001 Series C Bonds are to be surrendered for payment of the redemption price. Any defect in such notice or the failure to mail any such notice to DTC will not affect the validity of the proceedings for the redemption of any other 2001 Series C Bond.

If less than all the 2001 Series C Bonds of any maturity are called for redemption, the particular 2001 Series C Bonds so called for redemption shall be selected by the Trustee by such method as it deems fair and appropriate, except that so long as the book-entry only system remains in effect, in the event of any such partial redemption, DTC shall reduce the credit balances of the applicable DTC Participants with respect to the 2001 Series C Bonds and such DTC Participants shall in turn select those Beneficial Owners (as defined herein) whose ownership interests are to be extinguished by such partial redemption, each by such method as DTC or such DTC Participant, as the case may be, in its sole discretion, deems fair and appropriate.

### **Book-Entry Only System**

The following information concerning DTC and DTC's book-entry system has been obtained from DTC. The Corporation, the Trustee and the Underwriters assume no responsibility for the accuracy thereof.

DTC will act as securities depository for the 2001 Series C Bonds. The 2001 Series C Bonds will be issued as fully registered bonds registered in the name of Cede & Co. (DTC's partnership nominee) or such other nominee as may be requested by an authorized representative of DTC. One fully registered bond will be issued for each maturity of the 2001 Series C Bonds, each in the aggregate principal amount (initial principal amount in the case of the Capital Appreciation Bonds) of such maturity, and will be deposited with DTC.

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

Purchases of the 2001 Series C Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2001 Series C Bonds in DTC's records. The ownership interest of each actual purchaser of a 2001 Series C Bond (a "Beneficial Owner") will in turn be recorded in the Direct or Indirect Participants' records. Beneficial Owners will not receive written confirmations from DTC of their purchases, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 2001 Series C Bonds will be accomplished by entries made in the books of Participants acting on behalf of the Beneficial Owners. Beneficial Owners will not receive definitive bonds representing their ownership interests in the 2001 Series C Bonds except in the event that use of the book-entry system for the 2001 Series C Bonds is discontinued.

To facilitate subsequent transfers, all 2001 Series C Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. The deposit of 2001 Series C Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2001 Series C Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2001 Series C Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

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

Redemption notices will be sent to DTC. If less than all of the 2001 Series C Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in the 2001 Series C Bonds to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the 2001 Series C Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Corporation as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the 2001 Series C Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption premium, if any, and interest payments on the 2001 Series C Bonds will be made to DTC or such other nominee as may be requested by DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detailed information from the Corporation or the Trustee, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, the Corporation or the Trustee, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of the principal, redemption premium, if any, and interest to DTC is the responsibility of the Corporation and the Trustee. Disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

Each person for which a DTC Participant acquires an interest in the 2001 Series C Bonds, as nominee, may desire to make arrangements with such DTC Participant to receive a credit balance in the records of such DTC Participant, to have all communications to DTC which may affect such persons forwarded in writing by such DTC Participant, and to have notification made of all interest payments.

**The Corporation, the Trustee and the Underwriters will have no responsibility or obligation to DTC Participants, Beneficial Owners or other nominees of such Beneficial Owners for: (i) sending transaction statements; (ii) maintaining, supervising or reviewing the accuracy of any records maintained by DTC or any DTC Participant or other nominees of such Beneficial Owners; (iii) payment or the timeliness of payment by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owner, of any amount due with respect to the principal of or interest on (or accreted value of) 2001 Series C Bonds; (iv) delivery or timely delivery by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owners, of any notice or other communication which is required or permitted under the terms of the Trust Agreement to be given to the registered owners of 2001 Series C Bonds; or (v) any consent given or any action taken by DTC or its nominee as the registered owner of the 2001 Series C Bonds.**

#### **Discontinuance of the Book-Entry Only System**

DTC may discontinue providing its services as securities depository with respect to the 2001 Series C Bonds at any time by giving reasonable notice to the Corporation or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, definitive 2001 Series C Bonds will be printed and delivered.

The Corporation, in its sole discretion and without the consent of any other person, may terminate the services of DTC as securities depository with respect to the 2001 Series C Bonds. In such event, definitive 2001 Series C Bonds will be printed and delivered.

In the event that such book-entry only system is discontinued or the Corporation terminates the services of DTC as securities depository, the following provisions will apply: (i) payments of the principal of and the interest on the 2001 Series C Bonds will be made in lawful money of the United States of America; (ii) payments of principal will be made at the principal corporate trust office of the Trustee in New York, New York; (iii) interest on the 2001 Series C Bonds (other than capital appreciation bonds) will be paid by check mailed to the respective addresses of the registered owners thereof as of the fifteenth day of the month immediately preceding the interest payment date as shown on the registration books of the Corporation maintained by the Trustee; (iv) the 2001 Series C Bonds will be issued only as registered bonds without

coupons in denominations of \$5,000 principal amount (or maturity amount in the case of capital appreciation bonds) or any multiple thereof; and (v) the transfer of the 2001 Series C Bonds will be registrable and the 2001 Series C Bonds may be exchanged at the principal corporate trust office of the Trustee in New York, New York upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

## SOURCE OF PAYMENT AND SECURITY FOR THE BONDS

### General

Under the Trust Agreement, the Corporation will pledge the Notes to the Trustee and create a first lien on the Pledged Revenues (as defined in the Trust Agreement) for the benefit of the holders of the Bonds.

The Bonds are payable solely from and are secured by the Pledged Revenues, consisting of payments of principal of and interest on the Notes required to be deposited to the credit of the Bond Service Account and Redemption Account established under the Trust Agreement, any other monies deposited to the credit of those Accounts, including investment earnings thereon, and the monies on deposit in the Surplus Account established under the Trust Agreement, including investment earnings thereon. See Appendix I - "Summary of the Trust Agreement—Sinking Fund and Accounts."

**The Bonds do not constitute an obligation of the Commonwealth or any of its political subdivisions or public instrumentalities (other than the Corporation), and neither the Commonwealth nor any of its political subdivisions or public instrumentalities (other than the Corporation) shall be liable thereon. The Corporation has no taxing power.**

### The Act, the Notes and the Loans

As of June 30, 2001, the aggregate amount of principal and interest due on all Loans to Authorized Debtors held by Government Development Bank totaled approximately \$2.4 billion. These Loans had been made by Government Development Bank for the purpose of funding, among other things, capital expenditures and operating deficits of the Authorized Debtors. Prior to the enactment of the Act, the Loans did not have an established source of repayment. The Legislature of Puerto Rico approved the Act in order to provide a source of repayment for these Loans and enable Government Development Bank to sell the Loans in the capital markets through bond issues of the Corporation.

The Act requires Authorized Debtors to negotiate and execute with Government Development Bank the agreements necessary to recognize, formalize, restructure and/or refinance the Loans and to finance all expenses incurred in connection therewith. The Act provides that the Commonwealth, through budgetary appropriations during the next thirty Fiscal Years, commencing with Fiscal Year 2001-2002, will pay the principal of and interest on the Loans as the same may be restructured and/or refinanced under the Act. The Act provides, however, that such budgetary appropriations shall not exceed \$225 million per Fiscal Year.

On each date of delivery of the Series 2001 Bonds, Government Development Bank and the Corporation will enter into Debt Restructuring and Assignment Agreements with certain Authorized Debtors whereby the Authorized Debtors will agree to restructure and refinance all or a portion of their corresponding Loans. Pursuant to such Debt Restructuring and Assignment Agreements, such Authorized Debtors will execute the Series 2001 Notes and the Corporation will issue the Series 2001 Bonds and apply the net proceeds therefrom to purchase the Series 2001 Notes from Government Development Bank, without recourse to Government Development Bank.

The initial aggregate principal amount of the Series 2001 Notes will be equal to the initial aggregate principal amount of the Series 2001 Bonds and the interest payable on such Series 2001 Notes will be the same as the interest payable on the Series 2001 Bonds.

After the sale of the Series 2001 Notes to the Corporation, Government Development Bank will continue to hold certain Loans in the aggregate principal amount of approximately \$480 million. It is expected that such Loans will be restructured in the future and that the Corporation will issue additional Bonds to purchase additional Notes issued by the Authorized Debtors in connection with the restructuring of such Loans. Such additional Notes will be in a principal amount equal to the initial principal amount of the additional Bonds issued to purchase such Notes and will bear interest sufficient to cover the interest on the additional Bonds. After all the Loans have been restructured and sold to the Corporation as contemplated by the Act, the aggregate initial principal amount of the Notes will equal the aggregate initial

principal amount of the Bonds and the aggregate interest payable under the Notes will equal the aggregate interest payable under the Bonds. Such additional Bonds issued to purchase additional Notes may be privately placed with and held by Government Development Bank or sold in public offerings.

Under the Debt Restructuring and Assignment Agreements, Government Development Bank has agreed that it will not restructure and refinance any Loan if as a result thereof the annual interest, principal and other payments required to be made by the Authorized Debtors under the Notes and Loans would exceed \$225 million per Fiscal year.

Under the Notes, the Authorized Debtors are required to make on or before July 15 of each Fiscal Year, commencing July 15, 2002, payments thereunder equal to the sum of the following amounts, without duplication: (i) the interest on, principal of, redemption premium, if any, and Accreted Value of the Bonds which is due and payable in the Bond Year which begins during such Fiscal Year (whether at maturity, in connection with an Amortization Requirement, upon redemption or otherwise) less any amounts available in the Sinking Fund for the payment of such amounts in such Bond Year; (ii) any fees, expenses or other amounts becoming due and payable in such Bond Year to the provider (a "Facility Provider"), if applicable, of a credit facility or a liquidity facility (each a "Facility") under the agreement relating to such Facility or any amounts required to reimburse a Facility Provider for payments made under any such Facility in respect of the Bonds and not theretofore reimbursed; (iii) if applicable, all payments required to be made by the Corporation under any Swap Agreement (as defined in the Trust Agreement) (such payments being called the "Corporation Swap Payments") expected to be due and payable for such Bond Year (to the extent not already included in the portion corresponding to interest on the Bonds); (iv) any fees or reimbursement for expenses payable to the Trustee under the Trust Agreement; (v) if applicable, any amount then due by the Corporation to the Hedge Counterparty (as defined in the Trust Agreement) for breakage cost or other termination payment under the terms of any Swap Agreement; and (vi) any other amount becoming due and payable in such Bond Year in respect of the Bonds or becoming due and payable under the provisions of the Trust Agreement. See Appendix I - "Summary of the Trust Agreement." The aggregate principal and interest installments to be paid under the Notes will be sufficient to cover the aggregate principal amount of and the aggregate annual amount of interest payable on the Bonds, together with fees, expenses and other amounts payable by the Corporation or the Trustee with respect to the Bonds.

The Notes are payable solely from Legislative Appropriations to be made pursuant to the Act. The Act provides that (i) the Commonwealth shall honor, by means of budgetary appropriations, the payment of principal of and interest on the Notes and Loans, (ii) the Office of Management and Budget shall include in the operating budget of the Commonwealth submitted annually to the Legislature of Puerto Rico in each of the succeeding thirty Fiscal Years, commencing with Fiscal Year 2001-02, the amounts necessary to pay the principal of and interest on the Notes and Loans, up to a maximum annual amount of \$225 million per Fiscal Year, and (iii) the budgetary appropriations made thereunder may be used only for the payment of principal of and interest on the Notes and Loans and related costs, and are not subject to third party claims. The approved budget for Fiscal Year 2001-02 included an appropriation in respect of the Loans in the amount of approximately \$218 million. This amount is being applied by Government Development Bank to pay accrued interest on the Loans and to reduce the outstanding principal balance thereof.

The funds to be provided by the Commonwealth to make the payments required under the Notes and Loans are subject to and conditioned upon the appropriation of such funds by the Legislature of Puerto Rico in the annual budget of the Commonwealth. If all required annual Legislative Appropriations are made in full and all payments of principal and interest due under the Notes are timely paid, such payments will be sufficient to pay the principal of and interest on the Bonds as the same become due and payable, together with all amounts payable under the Trust Agreement. **The failure to make annual Legislative Appropriations in the amounts required would cause a shortfall in the monies available under the Notes to pay principal and interest due on the Bonds.**

#### **Special Considerations - Bonds are Limited Obligations; Legislature Not Legally Bound to appropriate; Investment of Funds**

The principal of, redemption premium, if any, and interest on the Bonds will be payable solely from the Legislative Appropriations made pursuant to the Act and other sources described above. **The Legislature of Puerto Rico is not legally bound to appropriate sufficient amounts to timely pay the principal of, redemption premium, if any, and interest due on the Bonds. There is no assurance that sufficient funds will be appropriated or otherwise made available to make such payments on the Bonds.** For a discussion of Puerto Rico's budgetary process, see "Budgetary Process and Payment of Commonwealth Obligations" below and the Commonwealth Report, which is incorporated herein by reference.

Bondholders have no legal recourse to require the Legislature of Puerto Rico to appropriate the funds necessary to timely pay the principal of, redemption premium, if any, and interest due on the Bonds.

Neither the Corporation nor the Commonwealth has ever defaulted on the payment of principal of or interest on any of its debt.

Pending their application for the payment of principal of and interest on the Bonds on the dates required, funds on deposit in the Sinking Fund (including funds representing the Legislative Appropriation) shall be invested by the Trustee as required by the Trust Agreement. Pursuant to the Trust Agreement, such funds may be invested, among other investments, in an investment agreement with a financial institution which has a long term debt rating in one of the three highest rating categories by Moody's and Standard & Poor's (without regards to any gradations within such categories). In addition, the portion of the proceeds of the Series C Bonds which will fund the payment of interest on such Bonds through August 1, 2002, may also be invested in an investment agreement with Government Development Bank. Losses incurred in connection with such investments may result in a shortfall in the monies available to pay principal and interest due on the Bonds. See Appendix I - "Summary of the Trust Agreement—Investment of Moneys."

#### **Letter of Credit**

Under the Commonwealth's Constitution, if the annual budget of capital expenditures and operating expenses of the Commonwealth for a Fiscal Year has not been adopted by June 30 of the preceding Fiscal Year, the budget for such preceding Fiscal Year is automatically renewed for the ensuing Fiscal Year, until a new budget for such succeeding Fiscal Year is approved by the Legislature of Puerto Rico and the Governor. This means that if the debt service on the Notes and the Loans held by Government Development Bank (if at such time not all Loans have been restructured and transferred to the Corporation as Notes in connection with the issuance of additional Bonds) for any Fiscal Year and, therefore, the annual budgetary appropriation for such Fiscal Year is less than the debt service on the Notes and such Loans in the immediately succeeding Fiscal Year, then in the case of a delay in the approval of the budget for such succeeding Fiscal Year, pending approval of the new budget, the budgetary appropriation that would carry over and be available to meet debt service on the Notes and such Loans for such succeeding Fiscal Year would be insufficient to meet the debt service on the Notes and such Loans. See "Budgetary Process and Payment of Commonwealth Obligations" below.

The maximum increase from one Fiscal Year to the next in the aggregate debt service on the Notes and any Loans remaining with Government Development Bank (the "Maximum Difference"), and thus, the Maximum Difference in the annual budgetary appropriation under the Act from one Fiscal Year to the next with respect to the payment of debt service on the Notes and such Loans as estimated by Government Development Bank based on its projected schedule of amortization of principal of such Loans, is approximately \$50,000,000.

To cover the risk that in any year during the term of the Bonds the budget is not adopted prior to June 30 and the budgetary appropriation that automatically carries over from the prior Fiscal Year may be insufficient to cover fully the debt service payments on the Bonds during the ensuing Bond Year, on the date of delivery of the 2001 Series C Bonds and 2001 Series D Bonds, Government Development Bank (in such capacity, the "Letter of Credit Bank"), will issue an irrevocable, transferable standby letter of credit (the "Letter of Credit") in favor of the Trustee solely for the benefit of the owners of the Bonds. The Letter of Credit will be in the stated amount of \$50,000,000, which amount represents the estimated Maximum Difference throughout the term of the Bonds, as discussed above. The Letter of Credit enables the Trustee to draw up to the full amount thereunder unless: (i) on or prior to July 30 of each Fiscal Year during the term of the Bonds it receives written notice from the Corporation to the effect that the operating budget of the Commonwealth for such Fiscal Year has been adopted and (ii) the Trustee has otherwise received funds representing the full amount of the principal and interest due with respect to the Bonds for the Bond Year commencing within such Fiscal Year. In connection with the issuance of additional Bonds, the Trustee may be required to consent to amendments to the Letter of Credit or release the Letter of Credit in exchange for a new letter of credit from Government Development Bank or a successor letter of credit meeting the requirements of the Trust Agreement. Such successor letter of credit or amended Letter of Credit would be in a stated amount higher or lower than the stated amount of the Letter of Credit to the extent the Maximum Difference increases or decreases as a result of the issuance of additional Bonds. See "Source of Payment and Security for the Bonds—Limitation on Additional Bonds."

The Letter of Credit will expire on August 15, 2030, subject to earlier termination upon a draw of the full amount thereunder which is not reinstated. The Letter of Credit will be reinstated in the amount of any drawing upon reimbursement to Government Development Bank of the full amount of such drawing. The Letter of Credit will not cover the risk that no appropriation is made by the Legislature of Puerto Rico under the Act for any particular Fiscal Year (or

that an appropriation is made pursuant to the Act in an amount lower than the amount of debt service on the Notes due with respect to any particular Fiscal Year). If the budget for any particular Fiscal Year is adopted but no appropriation for the payment of the Notes is included in such budget, the Trustee may not make a draw under the Letter of Credit. The Letter of Credit will be issued pursuant to a Letter of Credit and Reimbursement Agreement, dated as of the date of issuance of the 2001 Series C Bonds and 2001 Series D Bonds, by and between the Corporation and the Letter of Credit Bank. Appendix IV sets forth certain information with respect to the Letter of Credit Bank.

The Trust Agreement permits the Corporation to substitute the Letter of Credit for a letter of credit in the same stated amount for a term at least as long as the original Letter of Credit, containing administrative provisions reasonably acceptable to the Trustee and issued by a bank, banking association or trust company whose long-term obligations are rated at the time of issuance of the letter of credit in one of the three highest rating categories by Standard & Poor's and Moody's.

#### **Flow of Funds**

Under the Trust Agreement the Corporation agrees to cause the Secretary of the Treasury to transfer to the Trustee, no later than July 15 of each Fiscal Year while the Bonds are Outstanding, funds representing the entire Legislative Appropriation needed for the payment of all amounts due in respect of the Notes (including principal of and interest on the Bonds) for the immediately succeeding Bond Year, for deposit in the Sinking Fund as described below.

Any Legislative Appropriation (or funds received in substitution therefor or with respect to the Notes, including any monies received pursuant to a draw under the Letter of Credit) and other funds received by the Trustee, including any Hedge Counterparty Swap Payments (other than monies received from draws made under any Credit Facility or Liquidity Facility, other than the Letter of Credit, which monies will be deposited in special subaccounts as provided in the Trust Agreement) for the payment of principal of and interest on the Bonds shall be deposited in the Sinking Fund in the following order:

first, to the credit of the Bond Service Account, such amount as may be required to make the total amount then to the credit of the Bond Service Account equal to the sum of (i) the amount of interest then or to become due and payable on the Bonds of each Series then Outstanding during the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received; and (ii) the amount of principal then or to become due and payable not later than July 31 of such Bond Year on the Serial Bonds of each Series then Outstanding;

second, to the credit of the Redemption Account, such amount as may be required to make the total amount then to the credit of the Redemption Account in the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received equal to the Amortization Requirement for such Bond Year for the term Bonds of each Series then Outstanding; and

third, to the credit of the Surplus Account, any remaining amount.

Under the Trust Agreement, the Trustee is required to make a draw under the Letter of Credit on July 31 prior to any Bond Year unless it receives written notice from the Corporation prior to such date to the effect that a budget for the Fiscal Year commencing on the preceding July 1 has been adopted or it has otherwise received funds representing the entire Legislative Appropriation in respect of the Notes for such Bond Year.

Upon the delivery of the 2001 Series C Bonds and 2001 Series D Bonds, the Trustee will deposit to the credit of the Bond Service Account the sum of \$28,025,717.92, which sum will be applied by the Trustee to the payment of interest on the 2001 Series C Bonds and 2001 Series D Bonds becoming due through August 1, 2002. Such sum will not be available to pay any other debt service on the Series 2001 Bonds.

#### **No Acceleration of the Bonds**

The Bonds are not subject to acceleration upon the occurrence of an event of default or otherwise.

#### **Limitation on Additional Bonds**

No additional bonds may be issued under the Trust Agreement except to (i) fund the purchase by the Corporation of additional Notes covered by the Act, (ii) refund any Bonds issued under the Trust Agreement, (iii) fund a Reserve

Account, if applicable, or (iv) to pay the costs of issuance of such additional Bonds. All such additional Bonds will be issued on a parity with the Series 2001 Bonds and will be entitled to the same benefit and security under the Trust Agreement.

No additional Bonds may be issued unless the amounts of principal and interest payable under the Notes (assuming timely payments under the Notes) after the issuance of such additional Bonds are sufficient to pay the principal of and interest on all Bonds Outstanding after the issuance of such additional Bonds as the same become due, together with other amounts required to be paid by the Corporation with respect to the Bonds, any outstanding Credit or Liquidity Facility, if applicable, or under the Trust Agreement. In addition, no additional Bonds may be issued unless the Letter of Credit is amended or a successor letter of credit is issued in favor of the Trustee, if necessary, so that in either case the amount of the Letter of Credit or such successor letter of credit is not less than the estimated Maximum Difference after the issuance of such additional Bonds as certified by the Corporation. Any successor letter of credit must be issued by a bank, banking association or trust company whose long-term debt obligations are rated at the time of issuance of the letter of credit in any of the three highest rating categories (without regard to any gradations within any such category) by Standard & Poor's and Moody's.

### **Budgetary Process and Payment of Commonwealth Obligations**

The Fiscal Year of the Commonwealth begins on July 1 and ends on June 30 (references herein to a particular Fiscal Year are based on the year in which such Fiscal Year ends). The Governor is constitutionally required to submit to the Legislature of Puerto Rico an annual budget of capital improvements and operating expenses of the Commonwealth for the ensuing Fiscal Year. The annual budget is prepared by the Office of Management and Budget, working with the Planning Board, the Treasury Department, Government Development Bank and other government offices and agencies. Section 7 of Article VI of the Constitution of Puerto Rico provides: "The appropriations made for any Fiscal Year shall not exceed the total revenues, including available surplus, estimated for said Fiscal Year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

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

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

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 necessary to balance the budget, or make recommendations to the Legislature of Puerto Rico for new taxes, or take any other necessary action to meet the estimated deficiency, or authorize borrowings under provisions of existing legislation, or take action which involves a combination of such steps. 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 obligation and guaranteed debt); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain and certain commitments to protect the name, credit and good faith of the Commonwealth government; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purposes.

The Constitution of Puerto Rico provides that the public debt of the Commonwealth will constitute a first claim on available Commonwealth revenues. Public debt of the Commonwealth includes general obligation bonds and notes of the Commonwealth to which the full faith, credit and taxing power of the Commonwealth are pledged and, according to opinions rendered by the Attorney General of the Commonwealth, also any payments required to be made by the

Commonwealth under its guarantees of bonds and notes issued by its public instrumentalities. The Bonds do not constitute public debt of the Commonwealth for purposes of the constitutional provision described above.

For a description of the public debt of the Commonwealth and a more detailed discussion of the Commonwealth Budget, see the Commonwealth Report, which is incorporated herein by reference.

### PRO FORMA PUBLIC SECTOR DEBT OF THE COMMONWEALTH

The following table presents a summary of the public sector debt of the Commonwealth (1) as of June 30, 2001, as adjusted for the issuance on August 2, 2001 of the Corporation's 2001 Series A and Series B Bonds in the aggregate principal amount of \$390,000,000 (the "Prior 2001 Bonds") and the issuance on October 25, 2001 of the Commonwealth's Public Improvement Bonds of 2002, Series A and Series B and the Public Improvement Refunding Bonds, Series 2002A in the aggregate principal amount of \$1,312,960,000 (collectively, the "2002 Bonds") and the refunding of the bonds refunded thereby, (2) as further adjusted for the issuance of the Corporation's Series 2001 Bonds, and (3) as further adjusted for the issuance of the Public Improvement Refunding Bonds, Series 2002 in the principal amount of \$501,565,000 (the "Forward Delivery Bonds") and the refunding of the bonds referred thereby. The Forward Delivery Bonds have been sold and are expected to be delivered in April 2002. The table should be read in conjunction with the information set forth in "Debt" in the Commonwealth Report.

#### Commonwealth of Puerto Rico Public Sector Debt\* (in thousands)

	June 30, 2001 As Adjusted by the Issuance of the Prior 2001 Bonds and the 2002 Bonds <sup>(1)</sup>	June 30, 2001 As Adjusted by the Issuance of the Prior 2001 Bonds, the 2002 Bonds and the Series 2001 Bonds <sup>(1)</sup>	June 30, 2001 As Adjusted by the Issuance of the Prior 2001 Bonds, the 2002 Bonds, the Series 2001 Bonds and the Forward Delivery Bonds <sup>(1)</sup>
Puerto Rico direct debt . . . . .	\$ 5,936,380	\$ 5,936,380 <sup>(2)</sup>	\$ 5,933,185 <sup>(2)</sup>
Municipal debt . . . . .	1,632,170	1,632,170	1,632,170
Public corporations debt			
Puerto Rico guaranteed debt . . . . .	603,334	603,334	603,334
Debt supported by Puerto Rico appropriations or taxes . . . . .	12,142,612	14,050,481	14,050,481
Other non-guaranteed debt . . . . .	<u>6,539,423</u>	<u>6,539,423</u>	<u>6,539,423</u>
Total public corporations debt . . . . .	<u>19,285,369</u>	<u>21,193,238</u>	<u>21,193,238</u>
Total public sector debt . . . . .	<u>\$26,853,919</u>	<u>\$28,761,788</u>	<u>\$28,758,593</u>

\* For a complete recital of all notes to this table, see "Public Sector Debt" under "Debt" in the Commonwealth Report.  
 (1) Adjusted to exclude the bonds refunded thereby, including bonds refunded with proceeds that are or will be invested in guaranteed investment contracts and that will be considered to be outstanding under their authorizing resolutions and for purposes of calculating the Commonwealth's debt limitation.  
 (2) Adjusted to exclude payments of principal made on July 1, 2001.

Source: Government Development Bank.

## TAX MATTERS

The following is a summary of the opinion of Pietrantoní Méndez & Álvarez LLP, Bond Counsel, regarding certain Puerto Rico tax and United States federal income tax consequences of the ownership of the 2001 Series C Bonds. This section does not purport to cover all of the Puerto Rico tax and United States federal income tax consequences arising from the purchase and ownership of the 2001 Series C Bonds. The following is based upon laws and regulations now in effect and is subject to change.

In the opinion of Bond Counsel, based on the laws of Puerto Rico now in force:

1. Interest on the 2001 Series C Bonds is exempt from Puerto Rico income and withholdings taxes, including the alternative minimum tax imposed by Section 1017 of the Puerto Rico Internal Revenue Code of 1994, as amended (the "P.R. Code");

2. The 2001 Series C Bonds are exempt from property taxes imposed by the Municipal Property Tax Act of 1991, as amended, and interest thereon is exempt from the municipal license tax imposed by the Municipal License Tax Act of 1974, as amended;

3. The transfer of the 2001 Series C Bonds by (i) gift will not be subject to gift tax under the P.R. Code in the case of donors who are residents of the Commonwealth at the time the gift is made and (ii) death will not be subject to estate tax under the P.R. Code in the case of a decedent who at the time of death was (x) a resident of Puerto Rico and (y) a United States citizen who acquired such citizenship solely by reason of birth or residence in Puerto Rico;

4. Gain realized from the sale or exchange of a 2001 Series C Bond will be subject to income tax under the P.R. Code to taxpayers subject to Puerto Rico income tax on such gains, including individuals residing in Puerto Rico and corporations and partnerships organized under the laws of the Commonwealth;

5. The 2001 Series C Bonds will be considered an obligation of an instrumentality of Puerto Rico for purposes of (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the P.R. Code applicable to certain involuntary conversions and (ii) the exemption from the surtax imposed by Section 1102 of the P.R. Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of Puerto Rico and certain other investments; and

6. Interest on the 2001 Series C Bonds constitutes "industrial development income" under Section 2(j) of the Puerto Rico Industrial Incentives Act of 1963, the Puerto Rico Industrial Incentives Act of 1978, the Puerto Rico Tax Incentives Act of 1987, and the Puerto Rico Tax Incentives Act of 1998, as amended (collectively, the "Acts"), when received by a holder of a grant of tax exemption issued under any of the Acts that acquired the 2001 Series C Bonds with "eligible funds", as such term is defined in the Acts.

The P.R. Code does not provide rules with respect to the treatment of the excess, if any, of the amount due at maturity of a 2001 Series C Bond over its initial offering price (the "Accretion Amount"). Under the current administrative practice followed by the Puerto Rico Department of the Treasury, the Accretion Amount is treated as interest.

Prospective owners of the 2001 Series C Bonds, including but not limited to financial institutions, should be aware that ownership of the 2001 Series C Bonds may result in having a portion of their interest and other expenses attributable to interest on the 2001 Series C Bonds disallowed as deductions for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

In the opinion of Bond Counsel, based on the provisions of the United States Internal Revenue Code of 1986, as amended (the "Code"), now in force:

1. Interest on the 2001 Series C Bonds received by, or "original issue discount" (within the meaning of the Code) accrued to, a corporation (i) organized under the laws of Puerto Rico, or (ii) otherwise constituting a foreign corporation under the Code, is not subject to income taxation under the Code provided such interest or "original issue discount" is not effectively connected, or treated as effectively connected, with or attributable to the conduct of a trade or business within the United States by such corporation;

2. Interest on the 2001 Series C Bonds received by, or “original issue discount” (within the meaning of the Code) accrued to, an individual who is a *bona fide* resident of Puerto Rico during the entire taxable year in which such interest is received or “original issue discount” is accrued will constitute gross income from sources within Puerto Rico and, therefore, is excludable from gross income for purposes of the Code pursuant to section 933(1) thereof;

3. Interest on the 2001 Series C Bonds is not excludable from the gross income of the recipient thereof for federal income tax purposes under Section 103(a) of the Code;

4. A person that is subject to income tax under the Code on its worldwide income will generally be subject to federal income tax on any gain realized upon the sale or exchange of the 2001 Series C Bonds. However, pursuant to Notice 89-40 issued by the United States Internal Revenue Service on March 27, 1989, gain on the sale or exchange of the 2001 Series C Bonds by an individual who is a *bona fide* resident of Puerto Rico during the entire taxable year will constitute Puerto Rico source income and, therefore, qualify for the exclusion provided in Section 933(1) of the Code, provided such 2001 Series C Bonds do not constitute inventory in the hands of such individual; and

5. The transfer of the 2001 Series C Bonds by death or gift will not be subject to estate or gift tax under the Code in the case of decedents or donors who, at the time of death or gift, are (i) residents of Puerto Rico and (ii) (x) United States citizens that acquired such citizenship solely by reason of birth or residence in Puerto Rico or (y) not United States citizens.

Prospective owners of the 2001 Series C Bonds should also be aware that the Code provides special rules for the taxation of shareholders of foreign corporations that qualify as “controlled foreign corporations”, “personal holding companies”, “foreign personal holding companies” or “passive foreign investment companies”, as such terms are defined by the Code.

The opinion of Bond Counsel regarding the tax consequences under Puerto Rico law and the Code arising from ownership of, receipt or accrual of interest on, or disposition of the 2001 Series C Bonds is limited to the above.

#### CONTINUING DISCLOSURE UNDERTAKING

In accordance with the requirements of Rule 15c2-12, as amended (the “Rule”), promulgated by the Securities and Exchange Commission, the Corporation and the Commonwealth, as specifically stated hereinbelow, have agreed to provide or cause to provide the following:

1. The Commonwealth will provide to each NRMSIR and to any Commonwealth state information depository (“SID”) core financial information and operating data for each Fiscal Year, including (i) its audited financial statements prepared in accordance with generally accepted accounting principles in effect from time to time and (ii) material historical quantitative data (including financial information and operating data) on the Commonwealth, and information as to revenues, expenditures, financial operations and indebtedness of the Commonwealth, generally consistent with the information contained in the Commonwealth Report. Such information is expected to be filed within 305 days after the end of each Fiscal Year.

2. The Corporation will file, in a timely manner, with each NRMSIR or with the MSRB and any SID notice of the failure by the Commonwealth to comply with paragraph 1 above and notice of the occurrence of any of the following events with respect to the 2001 Series C Bonds if, in the judgment of the Corporation or its agent, such event is material:

- a. principal and interest payment delinquencies;
- b. non-payment related defaults;
- c. unscheduled draws on debt service reserves reflecting financial difficulties;
- d. unscheduled draws on credit enhancements reflecting financial difficulties;
- e. substitution of credit or liquidity providers, or their failure to perform;
- f. adverse opinions or events affecting the tax-exempt status of the 2001 Series C Bonds;
- g. modifications to rights of the holders (including beneficial owners) of the 2001 Series C Bonds;
- h. bond calls;
- i. defeasances;
- j. release, substitution, or sale of property securing repayment of the 2001 Series C Bonds; and
- k. rating changes.

The Corporation may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of the Corporation, such other event is material with respect to the 2001 Series C Bonds, but the Corporation does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

Event (c) is included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. However, event (c) may not be applicable since the terms of the 2001 Series C Bonds do not provide for “debt service reserves.” In addition, with respect to the following events:

Events (d) and (e). The Corporation does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the 2001 Series C Bonds, unless the Corporation applies for or participates in obtaining the enhancement.

Event (f). For information on the tax status of the 2001 Series C Bonds, see “Tax Matters.”

Event (h). The Corporation does not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if the terms, dates and amounts of redemption are set forth in detail in this Official Statement under “The 2001 Series C Bonds — Mandatory Redemption”, the only open issue is which 2001 Series C Bonds will be redeemed in the case of a partial redemption, notice of redemption is given to the Bondholders as required under the terms of the 2001 Series C Bonds, and public notice of the redemption is given pursuant to Securities Exchange Act of 1934 Release No. 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or 2001 Series C Bond purchases.

The Commonwealth expects to provide the information described in paragraph 1(ii) above by filing its first bond official statement that includes such information for the preceding Fiscal Year or, if no such official statement is issued by the 305-day deadline, by filing its Financial Information and Operating Data Report containing the information described in paragraph 1(ii) above by such deadline.

As of the date of this Official Statement, there is no Commonwealth SID, and the NRMSIRs are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's J.J. Kenny Repository, 55 Water Street, 45<sup>th</sup> Floor, New York, New York 10041; FT Interactive Data, Att: NRMSIR, 100 William Street, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Commonwealth and the Corporation acknowledge that their undertaking pursuant to the Rule described under this heading is intended to be for the benefit of the holders of the 2001 Series C Bonds, including Beneficial Owners, and shall be enforceable by any such holders or Beneficial Owners; provided that the right to enforce the provisions of this undertaking shall be limited to a right to obtain specific enforcement of the Corporation's or the Commonwealth's obligations hereunder, and any failure by the Corporation or the Commonwealth to comply with the provisions of this undertaking shall not be an event of default with respect to the 2001 Series C Bonds under the Trust Agreement. The Corporation further acknowledges that it has not failed to comply with any similar undertaking under the Rule for the last five years.

No bondholder or Beneficial Owner may institute any suit, action or proceeding at law or in equity (“Proceeding”) for the enforcement of the foregoing covenants (the “Covenants”) or for any remedy for breach thereof, unless such bondholder or Beneficial Owner shall have filed with the Corporation and the Commonwealth written notice of any request to cure such breach, and the Corporation or the Commonwealth, as applicable, shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in any Commonwealth court located in the Municipality of San Juan for the equal benefit of all bondholders or Beneficial Owners of the Outstanding 2001 Series C Bonds benefitted by the Covenants, and no remedy shall be sought or granted other than specific performance of any of the Covenants at issue. Notwithstanding the foregoing, no challenge to the adequacy of the information provided in accordance with the filings mentioned above may be prosecuted by any bondholder or Beneficial Owner except in compliance with the remedial and enforcement provisions contained in the Trust Agreement. Moreover, Proceedings filed by bondholders or Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Article 2 of Law No. 104 approved June 29, 1955, as amended (32 L.P.R.A. §3077), which governs the scope of legal actions against the Commonwealth and substantially limits the amount of monetary damages that may be granted against the Commonwealth.

The Covenants may only be amended if:

(1) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Corporation or the Commonwealth, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the 2001 Series C Bonds, after taking into account any amendments or change in circumstances; the amendment does not materially impair the interests of bondholders or Beneficial Owners, as determined by parties unaffiliated with the Corporation or the Commonwealth; and the amendment does not adversely affect the Trustee; or

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

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

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

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

## **UNDERWRITING**

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the 2001 Series C Bonds from the Corporation at an aggregate discount of \$8,260,204.40 from the initial public offering prices of the 2001 Series C Bonds set forth or derived from information set forth on the inside cover page hereof. The obligations of the Underwriters are subject to certain conditions precedent, and the Underwriters will be obligated to purchase all the 2001 Series C Bonds, if any 2001 Series C Bonds are purchased. The Underwriters may offer to sell the 2001 Series C Bonds to certain dealers and others at prices lower than the initial public offering prices, and such offering prices may be changed, from time to time, by the Underwriters.

## **LEGAL MATTERS**

The proposed form of opinion of Pietrantoni Méndez & Alvarez LLP, Bond Counsel, is attached as Appendix II to this Official Statement. Certain legal matters will be passed upon for the Underwriters by O'Neill & Borges, San Juan, Puerto Rico.

## **LEGAL INVESTMENT**

The 2001 Series C Bonds will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for domestic insurance companies.

## **GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

As required by Act No. 272 of the Legislature of Puerto Rico, approved May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the Corporation in connection with the 2001 Series C Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the 2001 Series C Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates participate in other financial transactions with Government Development Bank.



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## SUMMARY OF THE TRUST AGREEMENT

The following is a summary of certain provisions of the Trust Agreement. The statements contained herein do not purport to be complete and this summary is qualified in its entirety by reference to the Trust Agreement.

### Definitions of Certain Terms

The following words and terms have the following meanings, unless the context otherwise requires. Words importing the singular number include the plural number in each case and vice versa, and words importing persons include firms and corporations.

“**Accreted Value**” shall mean with respect to any Capital Appreciation Bond or Capital Appreciation and Income Bond (i) as of any Valuation Date, the amount set forth for such date in the resolution authorizing such Capital Appreciation Bond or Capital Appreciation and Income Bond and (ii) as of any date other than a Valuation Date, the sum of (a) the Accreted Value on the preceding Valuation Date (or, if there is no preceding Valuation Date, the initial principal amount) and (b) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date (or from the original issue date if there is no preceding Valuation Date) and the denominator of which is the number of days from such preceding Valuation Date (or from the original issue date if there is no preceding Valuation Date) to the next succeeding Valuation Date and (2) the difference between the Accreted Values for such Valuation Dates (or between the initial principal amount and the Accreted Value on the first Valuation Date).

“**Act**” shall mean Act Number 164 of the Legislature of Puerto Rico, approved December 17, 2001.

“**Amortization Requirement**” shall mean, for the Term Bonds of any Series for any Bond Year, the principal amount fixed or computed for the retirement by purchase or redemption of Term Bonds in such Bond Year.

The Amortization Requirement for the Term Bonds of each Series shall be initially in the respective principal amounts for each Bond Year as fixed in a resolution of the Corporation adopted prior to the issuance of the Bonds of such Series, and the aggregate amount of such Amortization Requirements for the Term Bonds of such Series shall be equal to the aggregate principal amount of the Term Bonds of such Series.

If at the close of any Bond Year the total principal amount of Term Bonds of any Series retired by purchase or redemption, or called for redemption under the provisions of the Trust Agreement during such Bond Year, shall be in excess of the amount of the Amortization Requirement for the Term Bonds of such Series for such Bond Year, then the amount of the Amortization Requirement for the Term Bonds of such Series shall be reduced for such subsequent Bond Years in such amounts aggregating the amount of such excess as shall be determined by the President of the Corporation in an order filed with the Trustee on or before the fifteenth (15th) day of the August following the close of such Bond Year.

It shall be the duty of the Trustee, on or before the 15th day of each Bond Year, to compute the Amortization Requirement for the then current Bond Year for the Term Bonds of each Series then Outstanding. The Amortization Requirement for the then current Bond Year shall continue to be applicable during the balance of such current Bond Year and no adjustment shall be made therein by reason of Term Bonds purchased or redeemed or called for redemption during such current Bond Year.

“**Appreciated Value**” shall mean, with respect to any Capital Appreciation and Income Bond (i) up to the Interest Commencement Date set forth in the resolution of the Board providing for the issuance of such Bond, an amount equal to the Accreted Value of such Bond and (ii) as of any date of computation on and after the Interest Commencement Date, an amount equal to the Accreted Value of such Bond on the Interest Commencement Date.

“**Authorized Debtors**” shall mean the departments, agencies, instrumentalities and public corporations of the Commonwealth authorized to recognize, formalize, restructure and/or refinance their advances, repayment commitments, obligations and/or loans with Government Development Bank pursuant to the Act.

**"Board"** shall mean the Board of Directors of the Corporation as constituted from time to time and which shall be the Board of Directors of Government Development Bank as provided by Resolution Number Five Thousand Forty-Four (5044), adopted December twelve (12), nineteen hundred eighty-four (1984) by the Board of Directors of Government Development Bank, as amended, or, if said Board shall be abolished, the board or body succeeding to the principal functions thereof or to whom the powers of the Corporation shall be given by law.

**"Bond Year"** shall mean the period commencing on the first day of August of any year and ending on the last day of July of the following year.

**"Bondholder," "Holder," "holder," "Holder of Bonds," or "Owner"** or any similar term, shall mean any person who shall be the registered owner of any Outstanding Bond or Bonds.

**"Bonds" or "bonds"** shall mean the bonds of the Corporation issued under the provisions of the Trust Agreement.

**"Business Day"** means a day other than a Saturday, Sunday or a day on which banks in the City of New York, New York, or San Juan, Puerto Rico, are authorized or required by law or executive order to close or are otherwise closed to the public.

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

**"Capital Appreciation and Income Bonds"** shall mean any Bonds the accruing interest on which is not paid prior to the Interest Commencement Date specified in the resolution authorizing such Bonds and the Appreciated Value for such Bonds is compounded periodically on the dates designated in such resolution prior to the Interest Commencement Date for such Capital Appreciation and Income Bonds, and which may be either Serial Bonds or Term Bonds.

**"Corporation"** shall mean Puerto Rico Public Finance Corporation, a governmental instrumentality of the Commonwealth of Puerto Rico and a wholly-owned subsidiary of Government Development Bank for Puerto Rico.

**"Corporation Swap Payments"** means the net payments required to be made by the Corporation to the Hedge Counterparty under a Rate Swap (if applicable).

**"Credit Facility"** shall mean an irrevocable letter of credit, policy of municipal bond insurance, guaranty, purchase agreement, credit agreement or similar facility in which the person providing such facility irrevocably agrees to provide funds to make payment of the principal of, premium, if any, and interest on Bonds to which such Credit Facility relates.

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

**"GDB Letter of Credit"** shall mean the irrevocable transferable stand-by letter of credit issued by Government Development Bank in favor of the Trustee solely for the benefit of the Bondholders on the date of issue of the Corporation's 2001 Series C Bonds and 2001 Series D Bonds.

**"Government Development Bank"** shall mean Government Development Bank for Puerto Rico.

**"Government Obligations"** shall mean (i) direct obligations of, or obligations the timely payment of principal of and the interest on which is unconditionally guaranteed by, the United States Government, (ii) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, any of the following: Banks for Cooperatives, Federal Farm Credit Banks, Federal Home Loan Banks, Export-Import Bank of the United States, Federal

Financing Bank, Government National Mortgage Association, Farmer's Home Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Housing Administration, and which obligations are rated at the time of purchase in the highest rating category by both Moody's and Standard & Poor's, (iii) all other obligations issued or unconditionally guaranteed as to principal and interest by an agency or instrumentality controlled or supervised by and acting as an instrumentality of the United States Government pursuant to authority granted by the Congress, which obligations are rated at the time of purchase in the highest rating category by both Moody's and Standard & Poor's and (iv) receipts evidencing the ownership of payments of principal or interest on any of such obligations, which receipts are rated in the highest rating category by both Moody's and Standard & Poor's.

**"Hedge Counterparty"** means the provider of any Rate Swap with respect to the Bonds as Counterparty under a Swap Agreement which provider must have a rating with respect to its long-term unsecured debt which is rated in one of the three highest rating categories (without regard to any gradation within such category) by Standard & Poor's or Moody's.

**"Hedge Counterparty Swap Payments"** means the net payments required to be made by a Hedge Counterparty to the Corporation under a Rate Swap.

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

**"Interest Payment Dates"** shall mean the dates on which interest on a Series of Bonds or portion thereof is scheduled to be due and payable, as is provided by a resolution of the Board adopted prior to the issuance of such Series of Bonds.

**"Interim Bonds"** shall mean any Bonds issued on an interim basis that are expected to be repaid from the proceeds of Bonds or other indebtedness.

**"Investment Agreement"** shall mean any agreement for the investment of moneys entered into by the Trustee with a Qualified Financial Institution or collateralized at all times by Government Obligations having a market value at least equal to the principal amount of such agreement, as to which collateral the Trustee has a perfected first priority security interest, which collateral is held by the Trustee or its agent free and clear of claims by third parties and which collateral will result in the agreement being rated in the highest rating category by both Moody's and Standard & Poor's.

**"Investment Obligations"** shall mean (i) Government Obligations, (ii) time deposits, certificates of deposit or similar arrangements with, or banker's acceptances issued by, any bank, banking association or trust company, including the Trustee, which is a member of the Federal Deposit Insurance Corporation having a combined capital and surplus aggregating not less than \$150,000,000 and reported deposits of not less than \$250,000,000, (iii) repurchase agreements with banks mentioned in (ii) above, including the Trustee, or with primary government dealers having a capital and surplus in excess of \$150,000,000, with respect to any of the securities mentioned in (i) above, provided such securities are on deposit with the Trustee (or any duly appointed agent of the Trustee) and such agreements are structured as sale - purchase agreements rather than secured loans, (iv) obligations issued by the Commonwealth or any state or territory of the United States, which are rated in one of the three highest rating categories (without regard to any gradations within such category) by both Moody's and Standard & Poor's, (v) municipal obligations, the payment of the principal of and the interest on which is insured, which are rated in one of the three highest rating categories (without regard to any gradations within such category) by both Moody's and Standard & Poor's, (vi) commercial paper rated, or backed by a letter of credit or line of credit the provider of which is rated, in the highest rating category (without regard to any gradations within such category) by both Moody's and Standard & Poor's, (vii) an Investment Agreement, (viii) money market accounts of any state, Commonwealth or federally chartered bank, banking association, trust company or subsidiary trust company, including the Trustee, that is rated or whose parent bank is rated in the highest short-term rating category or in the highest long-term rating category by Moody's or Standard & Poor's (without regard to any gradations within such category) or money market

funds registered under the Investment Company Act of 1940, as amended, whose shares are registered under the Securities Act of 1933, as amended, and having a rating by Standard & Poor's of "AAA-m-G" or "AAA-m", (ix) units of beneficial interest in any non-arbitrage investment program pools created by Government Development Bank or any of its subsidiaries or affiliates, (x) any obligation permitted under the laws of the Commonwealth which are rated in one of the three highest rating categories (without regard to any gradations within such category) by both Moody's and Standard & Poor's, and (xi) any securities otherwise permitted as eligible collateral under Act No. 69 of the Legislature of Puerto Rico, approved August 14, 1991, as amended.

**"Legislative Appropriation"** shall mean the funds appropriated by the Legislature of Puerto Rico in the annual budget of capital improvements and operating expenses of the Commonwealth for any Fiscal Year for the payment of the Notes pursuant to the provisions of the Act or, in the case such budget of the Commonwealth for any Fiscal Year has not been approved by the commencement of such Fiscal Year, until such budget is approved, the funds representing the amounts which had been appropriated in the budget of the Commonwealth for the previous Fiscal Year for the payment of the Notes pursuant to the provisions of the Act in accordance with Article VI, Section 6 of the Constitution of the Commonwealth.

**"Liquidity Facility"** shall mean a letter of credit, policy of municipal bond insurance, guaranty, purchase agreement or similar facility in which the person providing such facility agrees to provide funds to pay the purchase price of Put Bonds upon their tender by the Holders of Put Bonds.

**"Loans"** shall mean the advances, repayment commitments, obligations and/or loans of the Authorized Debtors specified in the Act.

**"Maximum Difference"** shall mean the maximum increase from one Fiscal Year to the next in the aggregate debt service on the Notes and on the Loans remaining with Government Development Bank.

**"Moody's"** means Moody's Investors Service, Inc., a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Corporation.

**"Notes"** shall mean promissory notes of the Authorized Debtors executed in connection with the restructuring of Loans pursuant to the Act and purchased with the proceeds of any Series of Bonds and pledged to the Trustee pursuant to the Trust Agreement.

**"Outstanding"** when used with reference to the Bonds shall mean, as of any date of determination, all Bonds theretofore authenticated and delivered except:

- a) Bonds theretofore cancelled by the Trustee or delivered to the Trustee for cancellation;
- b) Bonds that are deemed paid and no longer outstanding, as provided in the Trust Agreement;
- c) Bonds paid or Bonds in lieu of which other Bonds have been issued pursuant to the provisions of the Trust Agreement relating to Bonds destroyed, mutilated, stolen or lost, unless evidence satisfactory to the Trustee has been received that any such Bond is held by a bona fide purchaser;
- d) Bonds tendered or deemed tendered, as provided in the resolution of the Board for any Series of Bonds; and
- e) for purposes of any consent or other action to be taken under the Trust Agreement by the Holders of a specified percentage principal amount of Bonds, Bonds actually known by the Trustee to be held by or for the account of the Corporation.

**"Pledged Revenues"** shall mean all of the Corporation's right, title and interest in and to (i) all amounts paid and to be paid in respect of the Notes, (ii) all moneys and Investment Obligations on deposit to the credit of the Sinking Fund, (iii) the Hedge Counterparty Swap Payments, if any, and (iv) all investment earnings on the foregoing.

**“Put Bonds”** shall mean Bonds that by their terms may be tendered by and at the option of the Holder thereof for payment prior to the stated maturity thereof.

**“Qualified Financial Institution”** means the Federal National Mortgage Association, or any bank, trust company or national banking association, or a corporation subject to registration with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended, or any government securities dealer, insurance company or other financial institution, in each case whose unsecured obligations or uncollateralized long term debt obligations (or obligations guaranteed by its parent entity) shall at all times during the term of the Investment Agreement issued by such Qualified Financial Institution have been assigned a rating by Standard & Poor’s and Moody’s in one of the three highest rating categories (without regard to any gradations within any such category), or which has issued a letter of credit, contract or agreement in support of debt obligations which at all times shall have been so rated.

**“Rate Swap”** means any interest rate swap arrangement between the Corporation and a Hedge Counterparty pursuant to any Swap Agreement and related documentation.

**“Rating Agencies”** shall mean Standard & Poor’s and Moody’s.

**“Reimbursement Agreement”** shall mean any letter of credit and reimbursement agreement or other similar agreement to pay the amounts due to the provider of a Credit Facility or a Liquidity Facility between the Corporation and any provider of a Credit Facility or a Liquidity Facility.

**“Reimbursement Obligation”** shall mean all amounts payable by the Corporation to a provider of a Credit Facility or Liquidity Facility pursuant to its agreement with such provider, including any fees payable and expenses reimbursable to such provider.

**“Reimbursement Obligation Principal”** shall mean all Reimbursement Obligations of the Corporation to a provider of a Credit Facility or a Liquidity Facility other than the obligation to pay interest on amounts owing to the provider of such Credit Facility or Liquidity Facility under the agreement with the provider of such Credit Facility or Liquidity Facility.

**“Reserve Account”** shall mean the account of that name which may be established in the Sinking Fund.

**“Reserve Account Insurance Policy”** shall mean the insurance policy, surety bond or other evidence of insurance deposited to the credit of the Reserve Account in lieu of or in partial substitution for cash or securities on deposit therein, which policy, bond or other evidence of insurance constitutes an unconditional senior obligation of the issuer thereof. The issuer thereof shall be a municipal bond insurer whose senior debt obligations, ranking *pari passu* with its obligations under such policy, bond or other evidence of insurance, are rated, at the time of deposit for the credit of the Reserve Account, in any of the three highest rating categories (without regard to any gradations within any such category) by Moody’s and Standard & Poor’s.

**“Reserve Account Letter of Credit”** shall mean the irrevocable, transferable letter of credit deposited to the credit of the Reserve Account in lieu of or in partial substitution for cash or securities on deposit therein, which letter of credit constitutes an unconditional senior obligation of the issuer thereof. The issuer of such letter of credit shall be Government Development Bank or a banking association, bank or trust company or branch thereof whose senior debt obligations, ranking *pari passu* with its obligations under such letters of credit are rated at the time of deposit to the credit of the Reserve Account, in any of the three highest rating categories (without regard to any gradations within any such category) by Moody’s and Standard & Poor’s.

**“Serial Bonds”** shall mean the Bonds designated as serial bonds in the resolutions authorizing such Bonds.

**“Series”** shall mean all of the Bonds authenticated and delivered at one time on original issuance and pursuant to any resolution authorizing such Bonds as a separate Series of Bonds, or any Bonds thereafter authenticated and delivered in lieu of or in substitution for such Bonds pursuant to the Trust Agreement, regardless of variations in maturity, interest rate or other provisions.

**"Sinking Fund"** shall mean the "Puerto Rico Public Finance Corporation Act 164 Sinking Fund," a special fund created and designated pursuant to the Trust Agreement.

**"Standard & Poor's"** means Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, its successors, their assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "Standard & Poor's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Corporation.

**"Swap Agreement"** shall mean any Interest Rate Swap Agreement between the Corporation and a Hedge Counterparty related to the Bonds.

**"Term Bonds"** shall mean the Bonds designated as term bonds in the resolutions authorizing such Bonds.

**"Valuation Date"** shall mean, with respect to any Capital Appreciation Bond or Capital Appreciation and Income Bond, the date or dates set forth in the resolution authorizing such bonds on which Accreted Values are assigned to the Capital Appreciation Bonds or Capital Appreciation and Income Bonds.

**"Variable Rate Bonds"** shall mean Bonds issued with a variable, adjustable, convertible or similar interest rate that is not fixed in percentage at the date of issue for the term thereof.

### **Sinking Fund and Accounts**

A special fund is created under the Trust Agreement and designated the "Puerto Rico Public Finance Corporation Act 164 Sinking Fund" (the "Sinking Fund") to be held by the Trustee. There are created three separate accounts in the Sinking Fund designated "Bond Service Account," "Redemption Account," and "Surplus Account." If the resolution of the Board providing for the issuance of Bonds under the Trust Agreement requires that a Reserve Account be established, a separate account in the Sinking Fund designated "Reserve Account" is authorized to be created in accordance with such resolution. Subject to the terms and conditions set forth in the Trust Agreement, moneys held to the credit of the Sinking Fund shall be held in trust and applied by the Trustee solely for the purposes set forth below and pending such application shall be subject to the lien and charge created pursuant to the Trust Agreement until paid out or transferred as provided therein.

The Corporation shall cause the Secretary of the Treasury of the Commonwealth to transfer to the Trustee, no later than July 15 of each Fiscal Year while the Bonds are Outstanding, funds representing the entire Legislative Appropriation for such Fiscal Year.

All funds received by the Trustee representing the Legislative Appropriations (or funds received in substitution therefor or in respect of the Notes, including any moneys received pursuant to a draw under the GDB Letter of Credit) and other funds received by the Trustee, including any Hedge Counterparty Swap Payments (other than any moneys received from draws made under any Credit Facility or Liquidity Facility, other than the GDB Letter of Credit, which moneys will be deposited in special subaccounts as provided below), shall be deposited in the Sinking Fund in the following order:

first, to the credit of the Bond Service Account, such amount as may be required to make the total amount then to the credit of the Bond Service Account equal to the sum of (i) the amount of interest then or to become due and payable on the Bonds of each Series then Outstanding during the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received and (ii) the amount of principal then or to become due and payable not later than July 31 of such Bond Year on the Serial Bonds of each Series then Outstanding;

second, to the credit of the Redemption Account, such amount as may be required to make the total amount then to the credit of the Redemption Account in the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received equal to the Amortization Requirement for such Bond Year for the Term Bonds of each Series then Outstanding; and

third, to the credit of the Surplus Account, any remaining amount.

In lieu of any required deposit or in substitution of moneys on deposit to the credit of the Reserve Account (if applicable), the Corporation may cause to be deposited to the credit of the Reserve Account a Reserve Account Insurance Policy or a Reserve Account Letter of Credit in an amount equal to such required deposit, which Reserve Account Insurance Policy or Reserve Account Letter of Credit shall be satisfactory in form and substance to the Trustee and shall be payable or available to be drawn upon, as the case may be (upon the giving of notice as required thereunder), on any payment date for the Bonds on which a withdrawal from the Reserve Account would be required under the Trust Agreement, and give the Trustee the right to draw on any Reserve Account Insurance Policy or Reserve Account Letter of Credit prior to the expiration thereof unless the Corporation has furnished a replacement Reserve Account Insurance Policy or Reserve Account Letter of Credit or has provided sufficient moneys to make the amounts then on deposit to the credit of the Reserve Account equal to the amount required therefor. If a disbursement is made under a Reserve Account Insurance Policy or a Reserve Account Letter of Credit, the funds thereafter becoming available for deposit to the credit of the Reserve Account shall be used by the Trustee to reinstate the amounts available to be drawn under such Reserve Account Insurance Policy or Reserve Account Letter of Credit in an amount at least equal to the amount being reimbursed to the provider of such Reserve Account Insurance Policy or Reserve Account Letter of Credit or, if such reinstatement is not available, to deposit to the credit of the Reserve Account moneys in the amount of the disbursement made under such Reserve Account Insurance Policy or Reserve Account Letter of Credit or a combination of such alternatives.

If the Corporation issues Variable Rate Bonds pursuant to the Trust Agreement, the assumptions for calculating interest for the current Bond Year to ensure a sufficient deposit for the payment of said interest shall be made on the basis established in the resolution authorizing the issuance of such Variable Rate Bonds.

If there is a Credit Facility or a Liquidity Facility issued by a provider in connection with the issuance of a Series of Bonds, any moneys received from draws under such Credit Facility or a Liquidity Facility shall be deposited in separate subaccounts in the Bond Service Account or the Redemption Account, as appropriate, and used to pay the principal of and interest on the Bonds secured thereby.

To the extent required by a resolution of the Board in connection with the issuance of any Series of Bonds, the Trustee shall establish one or more subaccounts within the Bond Service Account and the Redemption Account to segregate amounts paid under any of the Notes and make withdrawals from such subaccounts to make payments under any Series of Bonds designated in such resolution. Nothing in the foregoing sentence shall be deemed to affect the parity status of the Bonds.

#### **Withdrawals from Bond Service Account**

On each Interest Payment Date or as otherwise provided in the resolution of the Board authorizing the issuance of a Series of Bonds, the Trustee shall withdraw from the Bond Service Account and (1) remit by mail (or by wire transfer if so provided by resolution of the Board) to each Holder of Bonds the amounts required for paying interest upon such Bonds as such interest becomes due, and (2) set aside sufficient moneys for paying the principal of Serial Bonds as such principal becomes due.

#### **Withdrawals from Redemption Account**

Moneys held to the credit of the Redemption Account shall be applied to the retirement of Bonds as follows:

(a) Subject to the provisions of paragraph (c) below, the Trustee shall endeavor to purchase Bonds or portions of Bonds, whether or not such Bonds or portions shall then be subject to redemption, at the most advantageous price obtainable with reasonable diligence, such price not to exceed the principal of such Bonds plus the amount of the premium, if any, that would be payable on the next redemption date to the holders of such Bonds under the redemption provisions of the Trust Agreement if such Bonds or portions of Bonds should be called for redemption on such date from

the moneys in the Sinking Fund. The Trustee shall pay the interest accrued on such Bonds or portions of Bonds to the date of delivery thereof from the Bond Service Account and the principal portion of such purchase price from the Redemption Account. No such purchase shall be made by the Trustee within the period of forty-five (45) days immediately preceding the date on which such Bonds are subject to call for redemption under the redemption provisions of the Trust Agreement except from moneys in excess of the amounts set aside or deposited for such redemption of Bonds;

(b) Subject to the provisions of paragraph (c) below, the Trustee shall call for redemption on each date on which Bonds are subject to redemption from moneys in the Sinking Fund such amount of Bonds or portions of Bonds then subject to redemption as, with the redemption premium, if any, will exhaust the moneys then held for the credit of the Redemption Account as nearly as may be; provided, however, that not less than \$100,000 principal amount of Bonds shall be called for redemption at anyone time. Such redemption shall be made pursuant to the redemption provisions of the Trust Agreement. Prior to calling Bonds or portions of Bonds for redemption the Trustee shall withdraw from the Bond Service Account and from the Redemption Account (including moneys transferred from the Reserve Account (if applicable) to the credit of the Redemption Account) and set aside in separate accounts or deposit with the paying agents the respective amounts required for paying the interest on, and the principal and redemption premium, if any, of the Bonds or portions of Bonds so called for redemption;

(c) Moneys in the Redemption Account shall be applied by the Trustee in each Bond Year to the retirement of Bonds of each Series then Outstanding in the following order:

first, the Term Bonds of each such Series to the extent of the Amortization Requirement, if any, for such Bond Year for the Term Bonds of each such Series then Outstanding, plus the applicable premium, if any, and, if the amount available in such Bond Year shall not be sufficient therefor, then in proportion to the Amortization Requirement, if any, for such Bond Year for the Term Bonds of each such Series then Outstanding, plus the applicable premium, if any;

second, any balance then remaining shall be applied to the purchase of any Bonds then Outstanding whether or not such Bonds shall then be subject to redemption, in accordance with the provisions of paragraph (a) above; and

third, any balance then remaining shall be applied to the retirement of Bonds of each Series as directed by the Corporation.

#### **Withdrawals from Surplus Account**

Moneys held to the credit of the Surplus Account shall be applied by the Trustee to make payments in the following order: (i) to make up any deficiency in the Bond Service Account and the Redemption Account; (ii) to pay the compensation of the Trustee and other amounts payable to the Trustee under the Trust Agreement upon the written request of the Corporation; (iii) to make Corporation Swap Payments (if applicable); (iv) to pay any fees and expenses payable to the providers of any Credit Facility, Liquidity Facility, Reserve Account Insurance Policy or Reserve Account Letter of Credit (if applicable); and (v) to reimburse or pay any provider of such facilities (if applicable) for any other amounts due under the agreement with such provider.

Any moneys held to the credit of the Surplus Account after all amounts described in the preceding paragraph required to be paid in respect of a Bond Year have been paid shall, upon the written request of the Corporation, be transferred to the credit of the Bond Service Account or the Redemption Account.

#### **Reserve Account**

If the resolution of the Board providing for the issuance of Bonds under the Trust Agreement requires that a Reserve Account be established, a separate account in the Sinking Fund designated "Reserve Account" is authorized to be created in accordance with said resolution, in which Reserve Account there shall be established separate subaccounts as provided in such resolution. In such event the Trustee shall, from the funds received by the Trustee in accordance with the Trust Agreement, prior to depositing any amounts to the credit of the Surplus Account, deposit to the credit of each

subaccount within the Reserve Account such amount as may be required to make the amount then on deposit to the credit of each such subaccount equal to the amount established in such resolution of the Board. Any Reserve Accounts created under the Trust Agreement will be applicable to one or more Series of Bonds issued under the Trust Agreement as provided in the resolution of the Board authorizing any such Series.

#### **Additional Bonds**

Additional Bonds may be issued under and secured by the Trust Agreement, subject to certain conditions, at any time or times solely for the purpose of (i) purchasing any additional Notes from Government Development Bank, (ii) providing funds for refunding all or any part of the Outstanding Bonds of anyone or more Series by payment at maturity or redemption at a selected redemption date or dates or combination of such payment at maturity and redemption, including the payment of any redemption premium thereon, (iii) making a deposit to a Reserve Account (if applicable), and (iv) paying the costs of issuance of such additional Bonds. No additional Bonds may be issued unless the amounts of principal and interest payable under the Notes after the issuance of such additional Bonds are sufficient to pay the principal of and interest on all Bonds Outstanding after the issuance of such additional Bonds, together with other amounts required to be paid by the Corporation with respect to the Bonds, any Credit Facility or Liquidity Facility relating thereto, any Corporation Swap Payments and the Trust Agreement. In addition, no additional Bonds may be issued unless the GDB Letter of Credit is amended or a successor letter of credit is issued in favor of the Trustee, if necessary, so that in either case the amount of the GDB Letter of Credit or such successor letter of credit is not less than the estimated Maximum Difference after the issuance of such additional Bonds as certified by the Corporation. Any successor letter of credit must be issued by a bank, banking association or trust company whose long-term debt obligations are rated at the time of issuance of the letter of credit in any of the three highest rating categories (without regard to any gradations within any such category) by Moody's and Standard & Poor's.

#### **Investment of Moneys**

Moneys held to the credit of the Bond Service Account and the Redemption Account (except any subaccounts established by one or more resolutions of the Board to segregate amounts received from a Credit Facility or a Liquidity Facility, which resolution or resolutions may provide for the investment of moneys deposited to the credit of any such subaccount) shall, as nearly as may be practicable, be continuously invested and reinvested, at the written direction of the Corporation, in (i) Government Obligations that shall mature, or that shall be subject to redemption by the holder thereof at the option of such holder, not later than the respective dates when moneys held for the credit of said accounts will be required for the purposes intended; or (ii) Investment Agreements pursuant to which funds would be available not later than the respective dates when moneys held for the credit of said accounts would be required for the purposes intended. Moneys held to the credit of the Surplus Account shall be continuously invested and re-invested at the written direction of the Corporation in any Investment Obligations selected by it. Moneys held to the credit of the Reserve Account (if applicable) shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Corporation in Investment Obligations that shall mature no later than the final maturity of the Bonds.

Obligations so purchased as an investment of moneys in any such fund or account shall be deemed at all times to be a part of such fund or account, and any investment earnings and profit or loss realized on the sale or maturity thereof, shall be credited or debited to such fund or account; provided, however, that if the required deposit to any account in the Sinking Fund has been made for the current Bond Year, the investment earnings on moneys held to the credit of such account shall be deposited to the credit of any other account of the Sinking Fund for which such required deposit has not been made, in the order required by the Trust Agreement, and thereafter shall be deposited to the credit of such account in the Sinking Fund as shall be directed by the Corporation.

#### **No Impairment**

The Corporation covenants and agrees that, so long as any of the Bonds shall be Outstanding and so long as any of its other obligations under any Reimbursement Agreement (if applicable) or Swap Agreement (if applicable) shall remain unpaid, none of the Pledged Revenues will be used for any purpose other than as provided in the Trust Agreement, and that no contract or contracts will be entered into or any action taken by which the rights of the Trustee, the holders or such other parties secured by the Trust Agreement to such Pledged Revenues might be impaired or diminished.

### **Inclusion of Principal and Interest Requirement in Budget**

Each year while any Bonds are Outstanding, the Corporation shall file a timely request with the Director of the Office of Management and Budget of Puerto Rico to include in the annual budget of capital improvements and operating expenses of the Commonwealth for the next Fiscal Year the necessary Legislative Appropriation so that payments in respect of the Notes shall be sufficient to cover the principal and interest payable with respect to the Bonds and all other amounts payable in respect of the Bonds or payable under the Trust Agreement during the next Bond Year.

### **Enforcement of Remedies**

At the request of the holders of not less than 20% of the aggregate principal amount of Bonds then Outstanding, the Trustee shall proceed, subject to the Trustee's rights to indemnification under the Trust Agreement, to protect and enforce its rights and the rights of the holders under the laws of Puerto Rico or under the Trust Agreement, including all rights with respect to the Notes and the Pledged Revenues, provided, that the Trustee may not sell or otherwise dispose of the Notes.

### **Pro Rata Application of Funds**

If at any time the moneys in the Sinking Fund shall not be sufficient to pay the interest on or the principal of the Bonds as the same shall become due and payable, such moneys (except for any moneys obtained from a drawing on a Credit Facility, other than the GDB Letter of Credit, or Liquidity Facility (if applicable) and deposited in a separate subaccount which shall secure only one or more specified Series of Bonds or moneys deposited in any subaccount within the Reserve Account that secures only such specified Series of Bonds), together with any moneys then available or thereafter becoming available for such purpose, whether through the exercise of the remedies provided for in the Trust Agreement or otherwise, shall be applied as follows:

first, to the payment to the persons entitled thereto of all installments of interest then due and payable in the order in which such installments became due and payable and, if the amount available shall not be sufficient to pay in full any particular installment, then to the payment, ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in such Bonds;

second, to the payment to the persons entitled thereto of the unpaid principal of any of the Bonds which shall have become due and payable (other than Bonds called for redemption for the payment of which moneys are held pursuant to the provisions of the Trust Agreement) in the order of their due dates, with interest on such Bonds at the respective rates specified therein from the respective dates upon which such Bonds became due and payable, and, if the amount available shall not be sufficient to pay in full the principal of such Bonds due and payable on any particular date, together with such interest, then to the payment first of such interest, ratably, according to the amount of such interest due on such date, and then to the payment of such principal, ratably, according to the amount of such principal due on such date, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in such Bonds;

third, to the payment of the interest on and the principal of such Bonds, to the purchase and retirement of Bonds and to the redemption of Bonds, all in accordance with the provisions of the Trust Agreement;

fourth, to the payment of any amounts then due and owing to a provider of a Credit Facility or a Liquidity Facility (if applicable); and

fifth, to the payment of any amounts then due and payable to a Hedge Counterparty under a Swap Agreement (if applicable).

### **Supplemental Agreements Without Bondholders' Consent**

The Corporation and the Trustee may, without the consent or approval of, or notice to, any of the Bondholders, from time to time and at any time, enter into agreements supplemental to the Trust Agreement as shall not be inconsistent with the terms and provisions thereof, for the following purposes:

(a) to cure any ambiguity or formal defect or omission in the Trust Agreement or in any supplemental agreement or to correct or supplement any provision contained therein that may be defective or inconsistent with any other provisions contained therein; or

(b) to grant to or confer upon the Trustee for the benefit of the Bondholders any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Bondholders or the Trustee; or

(c) to add to the conditions, limitations and restrictions on the issuance of Bonds under the provisions of the Trust Agreement, other conditions, limitations and restrictions thereafter to be observed; or

(d) to add to the covenants and agreements of the Corporation in the Trust Agreement other covenants and agreements thereafter to be observed by the Corporation or to surrender any right or power therein reserved to or conferred upon the Corporation; or

(e) to permit the issuance of Bonds in coupon form, if the conditions precedent stated therein have been met; or

(f) to qualify the Bonds or any of the Bonds for registration under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended; or

(g) to qualify the Trust Agreement as an "indenture" under the Trust Indenture Act of 1939, as amended; or

(h) to make such changes as may be necessary to adjust the terms of the Trust Agreement so as to facilitate the issuance of Variable Rate Bonds, Capital Appreciation Bonds, Capital Appreciation and Income Bonds, Put Bonds, Interim Bonds and such other Bonds as may be marketable from time to time; or

(i) to make such changes as may be necessary to comply with the provisions of Puerto Rico law relating to the exclusion of interest on the Bonds from gross income thereunder; or

(j) to make such changes as may evidence the right and interest of an issuer of a Credit Facility or a Liquidity Facility that secures any Series of Bonds; or

(k) to make such changes as may be necessary to create a Reserve Account for any Bonds Outstanding.

#### **Modification with Consent of Holders of Majority of Bonds**

Subject to the terms and provisions contained in the Trust Agreement, and not otherwise, the holders of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding (or in case less than all of several Series of Bonds then Outstanding are affected by the proposed supplemental agreement, the holders of not less than a majority in principal amount of the Bonds of each Series so affected and Outstanding at the time the consent is given) shall have the right, from time to time, anything contained in the Trust Agreement to the contrary notwithstanding, to consent to and approve the execution by the Corporation and the Trustee of such agreement or agreements supplemental thereto as shall be deemed necessary or desirable by the Corporation for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Trust Agreement or in any supplemental agreement; provided, however, that nothing contained in the Trust Agreement shall permit, or be construed as permitting, without the consent of the holders of 100% of the Bonds Outstanding affected by the proposed supplemental agreement (a) an extension of the time for the payment of the principal of (other than as provided by the terms of an Extendible Maturity Bond) or the interest on any Bond, or (b) a reduction in the principal amount of any Bond or the redemption premium or the rate of interest thereon, or (c) the creation of any lien or a pledge of funds other than the lien and pledge created by the Trust Agreement, or (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, or (e) a reduction in the aggregate principal amount of the Bonds required for consent to such supplemental agreement or any waiver under the Trust Agreement.

## **Amendments to the Notes**

The Trustee (as assignee of the Notes) may enter into, from time to time and at any time, such amendments to the Notes, in form satisfactory to the Trustee, as shall not be inconsistent with the terms and provisions thereof to (a) cure any ambiguity or formal defect or omission in the Notes, provided such action shall not materially adversely affect the interests of the Bondholders, or (b) grant to or confer upon the Corporation or Trustee for the benefit of the Bondholders any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Corporation or Bondholders or the Trustee, or (c) provide for the substitution of any Notes for other notes of Authorized Debtors, provided that such substitution does not restrict, limit or reduce the obligation of the Authorized Debtors to make payments sufficient to pay the principal of and interest on the Bonds, or otherwise impair the security of the Bondholders of any Series of Bonds under the Trust Agreement, or (d) make any other change which, in the judgment of the Trustee, based upon an opinion of counsel, will not restrict, limit or reduce the obligation of the Authorized Debtors to make the payments under the Notes sufficient to pay the principal of or interest on the Bonds, or otherwise impair the security of the Bondholders under the Trust Agreement.

Except for amendments provided for in the preceding paragraph, the Trustee shall not enter into any amendment to the Notes unless notice of the proposed amendment shall have been given and the holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall have consented to and approved the execution thereof, all as provided for under "Modification with Consent of Holders of Majority of Bonds" above; and provided further that without the consent of all of the holders of the Bonds Outstanding affected by such change, no such amendment shall be entered into by the Trustee which would restrict, limit or reduce the obligations of the Authorized Debtors with respect to the Bonds.

## **Defeasance**

If all the Outstanding Bonds shall have been paid or deemed to have been paid as provided below and all amounts due and owing to any provider of a Credit Facility, Liquidity Facility or Rate Swap shall have been paid, then and in that case the right, title and interest of the Trustee under the Trust Agreement shall cease, terminate and become void, and such Bonds shall cease to be entitled to any benefit or security under the Trust Agreement. In such event, the Trustee shall transfer and assign to the Corporation all property then held by the Trustee, shall execute such documents as may be reasonably required by the Corporation to evidence such transfer and assignment and shall turn over to the Corporation any surplus in any account in the Sinking Fund.

Any Outstanding Bond shall be deemed to have been paid within the meaning and with the effect expressed in the Trust Agreement when the whole amount of the principal of and interest on such Bond shall have been paid or when (a) there shall have been deposited with the Trustee or another fiduciary institution acting as escrow agent for the holder of such Bond either moneys in an amount which shall be sufficient, or Government Obligations, which shall not contain provisions permitting the redemption thereof at the option of the issuer, the principal of and interest on which when due, and without any reinvestment thereof, will provide moneys which, together with the moneys, if any, deposited with or held by the Trustee available therefor, shall be sufficient, to pay when due the principal of and premium, if any, and interest due and to become due on such Bond on or prior to the redemption date or maturity date thereof, as the case may be, and (b) in the event such Bond does not mature and is not to be redeemed within the next succeeding sixty 60 days, the Corporation shall have given the Trustee irrevocable instructions to give, as soon as practicable, a notice to the holder of such Bond by first-class mail, postage prepaid, stating that the deposit of moneys or Government Obligations has been made with the Trustee or another fiduciary institution acting as escrow agent for the holder of such Bond and that such Bond is deemed to have been paid in accordance with the Trust Agreement and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal of and premium, if any, and interest on such Bond.

## PROPOSED FORM OF OPINION OF BOND COUNSEL

December 27, 2001

Puerto Rico Public Finance Corporation  
San Juan, Puerto Rico

Ladies and Gentlemen:

We have examined Act No. 17 of the Legislature of Puerto Rico approved September 23, 1948, as amended, creating Government Development Bank for Puerto Rico ("Government Development Bank") as a public corporation and a governmental instrumentality of the Commonwealth of Puerto Rico (the "Commonwealth"), Resolution No. 5044, as amended, of Government Development Bank and other proofs submitted in connection with the creation by Government Development Bank of a subsidiary of Government Development Bank and an independent governmental instrumentality of the Commonwealth designated Puerto Rico Public Finance Corporation (the "Corporation").

We have also examined certified copies of the Resolution of the Board of Directors of the Corporation (the "Resolution") authorizing the execution and delivery of a Trust Agreement, dated December 27, 2001 (the "Trust Agreement"), by and between the Corporation and The Bank of New York, Trustee (the "Trustee"), and other proofs submitted relative to the authorization, issuance and sale of

**\$771,274,288.85**  
**PUERTO RICO PUBLIC FINANCE CORPORATION**  
**2001 SERIES C BONDS**

bearing interest at such rates, payable on such dates, maturing in such principal amounts and subject to redemption prior to maturity, all as set forth in the Resolution and the Trust Agreement (the "2001 Series C Bonds").

The proceeds of the 2001 Series C Bonds are to be used by the Corporation to purchase from Government Development Bank the promissory notes (the "Series C Purchased Notes") of certain departments, agencies, instrumentalities or public corporations of the Commonwealth (the "Authorized Debtors") specified in the Resolution and pay expenses incurred in connection with the issuance of the 2001 Series C Bonds. Concurrently with the issuance of the 2001 Series C Bonds, the Corporation is issuing its 2001 Series D Bonds and proposes to issue on or about January 16, 2002 its 2001 Series E Bonds (collectively with the 2001 Series C Bonds, the "2001 Bonds") for the purpose of providing the Corporation with the necessary funds to purchase from Government Development Bank certain other promissory notes (such notes, together with the Series C Purchased Notes, being collectively called the "2001 Purchased Notes") of Authorized Debtors.

Pursuant to the Trust Agreement, the Corporation is authorized to issue additional series of bonds from time to time to purchase from Government Development Bank additional promissory notes of Authorized Debtors (the "Additional Notes" and together with the 2001 Purchased Notes, the "Notes") and to refund the 2001 Bonds and any other bonds issued under the Trust Agreement upon the terms and conditions set forth therein, and any such bonds will be on a parity with the 2001 Bonds and all other bonds issued under the Trust Agreement (all such additional series of bonds, together with the 2001 Bonds, being herein collectively called the "Bonds").

The principal of and the interest on the 2001 Bonds are payable solely from Pledged Revenues (as defined in the Trust Agreement), initially consisting of payments of principal of and interest on the 2001 Purchased Notes and other funds held by the Trustee under the Trust Agreement. Upon issuance of additional bonds under the Trust Agreement for the purpose of providing funds to purchase Additional Notes, the Pledged Revenues shall also include payments of principal of and interest on such Additional Notes purchased. The principal of and interest on the Notes is payable solely from annual appropriations made by the Legislature of Puerto Rico pursuant to Act No. \_\_\_\_ of the Legislature of Puerto Rico approved on December 17, 2001.

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

From such examination, we are of the opinion that:

- (a) Said Act No. 17, as amended, has been validly enacted and is in full force and effect, and said Resolution No. 5044, as amended, has been duly adopted and is in full force and effect, and the Corporation is a duly constituted and existing subsidiary corporation of Government Development Bank and an independent governmental instrumentality of the Commonwealth.
- (b) The Resolution has been validly and legally adopted.
- (c) As authorized by said Resolution No. 5044, as amended, and by the Resolution, the Trust Agreement has been duly executed and delivered.
- (d) The 2001 Series C Bonds have been duly authorized and issued, among other things, to provide funds for the purchase of the Series C Purchased Notes.
- (e) The 2001 Series C Bonds are valid and binding obligations of the Corporation, payable solely from Pledged Revenues (as defined in the Trust Agreement), consisting initially of payments of principal of and interest on the 2001 Purchased Notes and other funds held by the Trustee under the Trust Agreement.
- (f) The 2001 Series C Bonds do not constitute a debt of the Commonwealth, any of its public instrumentalities (other than the Corporation) or any of its municipalities or other political subdivisions, and neither the Commonwealth, any of its public instrumentalities (other than the Corporation) nor any of such municipalities or other political subdivisions are liable thereon.
- (g) Based on the laws of the Commonwealth now in force:
  1. Interest on the 2001 Series C Bonds is exempt from Puerto Rico income and withholding taxes, including the alternative minimum tax imposed by Section 1017 of the Puerto Rico Internal Revenue Code of 1994, as amended (the "P.R. Code").
  2. The 2001 Series C Bonds are exempt from property taxes imposed by the Municipal Property Tax Act of 1991, as amended, and interest thereon is exempt from the municipal license tax imposed by the Municipal License Tax Act of 1974, as amended.
  3. The transfer of the 2001 Series C Bonds (i) by gift will not be subject to gift tax under the P.R. Code in the case of donors who are residents of the Commonwealth at the time the gift is made and (ii) by death will not be subject to estate tax under the P.R. Code in the case of a decedent who at the time of death was (x) a resident of Puerto Rico and (y) a United States citizen who acquired such citizenship solely by reason of birth or residence in Puerto Rico.

4. Gain realized from the sale or exchange of a 2001 Series C Bond will be subject to income tax under the P.R. Code to taxpayers subject to Puerto Rico income tax on such gains, including individuals residing in Puerto Rico and corporations and partnerships organized under the laws of the Commonwealth.

5. The 2001 Series C Bonds will be considered an obligation of an instrumentality of the Commonwealth for purposes of (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the P.R. Code applicable to certain involuntary conversions and (ii) the exemption from the surtax imposed by Section 1102 of the P.R. Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of the Commonwealth and certain other investments.

6. Interest on the 2001 Series C Bonds constitutes "industrial development income" under Section 2(j) of the Puerto Rico Industrial Incentives Act of 1963, the Puerto Rico Industrial Incentives Act of 1978, the Puerto Rico Tax Incentives Act of 1987, and the Puerto Rico Tax Incentives Act of 1998, as amended (collectively, the "Acts"), when received by a holder of a grant of tax exemption issued under any of the Acts that acquired the 2001 Series C Bonds with "eligible funds", as such term is defined in the Acts.

(h) Based on the provisions of the United States Internal Revenue Code of 1986, as amended (the "Code"), now in force:

1. Interest on the 2001 Series C Bonds received by, or "original issue discount" (within the meaning of the Code) accrued to, a corporation (i) organized under the laws of the Commonwealth, or (ii) otherwise constituting a foreign corporation under the Code, is not subject to income taxation under the Code provided such interest or "original issue discount" is not effectively connected, or treated as effectively connected, with or attributable to the conduct of a trade or business within the United States by such corporation.

2. Interest on the 2001 Series C Bonds received by, or "original issue discount" (within the meaning of the Code) accrued to, an individual who is a *bona fide* resident of the Commonwealth during the entire taxable year in which such interest is received or "original issue discount" is accrued will constitute gross income from sources within the Commonwealth and, therefore, is excludable from gross income for purposes of the Code pursuant to Section 933(1) thereof.

3. Interest on the 2001 Series C Bonds is not excludable from the gross income of the recipient thereof for federal income tax purposes under Section 103(a) of the Code.

4. A person that is subject to income tax under the Code on its worldwide income will generally be subject to federal income tax on any gain realized upon the sale or exchange of the 2001 Series C Bonds. However, pursuant to Notice 89-40 issued by the United States Internal Revenue Service on March 27, 1989, gain on the sale or exchange of the 2001 Series C Bonds by an individual who is a *bona fide* resident of the Commonwealth during the entire taxable year will constitute Puerto Rico source income and, therefore, qualify for the exclusion provided in Section 933(1) of the Code, provided such 2001 Series C Bonds do not constitute inventory in the hands of such individual.

5. The transfer of the 2001 Series C Bonds by death or gift will not be subject to estate or gift tax under the Code in the case of decedents or donors who, at the time of death or gift, are (i) residents of Puerto Rico and (ii) (x) United States citizens that acquired such citizenship solely by reason of birth or residence in Puerto Rico or (y) not United States citizens.

The P.R. Code does not provide rules with respect to the treatment of the excess, if any, of the amount due at maturity of a Series C Bond over its initial offering price (the "Accretion Amount"). Under the current administrative practice followed by the Department of the Treasury of the Commonwealth, the Accretion Amount is treated as interest.

Prospective owners of the 2001 Series C Bonds, including but not limited to financial institutions, should be aware that ownership of the 2001 Series C Bonds may result in having a portion of their interest and other expenses attributable to interest on the 2001 Series C Bonds disallowed as deductions for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

Prospective owners of the 2001 Series C Bonds should also be aware that the Code provides special rules for the taxation of shareholders of foreign corporations that qualify as "controlled foreign corporations", "personal holding companies", "foreign personal holding companies" or "passive foreign investment companies", as such terms are defined by the Code.

Other than as described herein, we have not addressed, and we are not opining upon, the federal or Commonwealth income tax consequences to any investor arising from the ownership of, receipt or accrual of interest on, or disposition of the 2001 Series C Bonds.

Very truly yours,

**DESCRIPTIONS OF INVESTMENT GRADE RATINGS  
BY MOODY'S AND STANDARD & POOR'S**

**Description of Moody's Long Term Ratings**

The purpose of Moody's ratings is to provide investors with a simple system of gradation by which the relative investment qualities of bonds may be noted. There are nine basic rating categories for long-term obligations, ranging from Aaa (highest quality) to C (lowest quality). Moody's applies numerical modifiers 1, 2 and 3 in each generic rating classification from Aa to Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of the generic ratings category.

- Aaa** Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edged". Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.
- Aa** Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high-grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risks appear somewhat larger than in Aaa securities.
- A** Bonds which are rated A possess many favorable investment attributes and are to be considered as upper-medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment sometime in the future.
- Baa** Bonds which are rated Baa are considered as medium-grade obligations (i.e., they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

**Description of Standard & Poor's Municipal and Corporate Debt Ratings**

A Standard & Poor's issue credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program (including ratings on medium term note programs and commercial paper programs). It takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated.

The issue credit rating is not a recommendation to purchase, sell or hold a financial obligation, inasmuch as it does not comment as to market price or suitability for a particular investor.

The ratings are based on current information furnished by the obligors or obtained by Standard and Poor's from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any credit rating and may, on occasion, rely on unaudited financial information. Credit ratings may be changed, suspended or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances.

The ratings are based, in varying degrees, on the following considerations:

1. Likelihood of payment — capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation;

2. Nature of and provisions of the obligation;
3. Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

Investment grade:

- AAA** An obligation rated "AAA" has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is **EXTREMELY STRONG**.
- AA** An obligation rated "AA" differs from the highest-rated obligations only in small degree. The obligor's capacity to meet its financial commitment on the obligation is **VERY STRONG**.
- A** An obligation rated "A" is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still **STRONG**.
- BBB** An obligation rated "BBB" exhibits **ADEQUATE** protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

The following information has been obtained from Government Development Bank. Neither the Corporation nor the Underwriters have verified such information, and they shall have no liability with respect to such information.

Government Development Bank is a government instrumentality of the Commonwealth created by Act No. 17 of the Legislature of Puerto Rico, approved September 13, 1948, as amended. Government Development Bank's primary purpose is to act as fiscal agent for the Commonwealth and its public entities. In that capacity, Government Development Bank acts as fiscal agent in connection with all short-term borrowings and bond issues of the Commonwealth, its public corporations and municipalities. In addition, Government Development Bank makes loans to the Commonwealth, its public corporations and municipalities, and to the private sector.

As of June 30, 2000, Government Development Bank had total assets of \$8.3 billion, total deposits of \$3.5 billion and capital of \$1.6 billion. For the year ended June 30, 2000, it reported net income of \$102.5 million.

As of June 30, 2001, Government Development Bank had total assets of \$7.8 billion, total deposits of \$3.1 billion and capital of \$1.7 billion. For the year ended June 30, 2001, it reported net income of \$84.9 million.

The principal offices of Government Development Bank are located at Minillas Government Center, De Diego Avenue, Stop 2, Santurce, Puerto Rico. For more detailed information on Government Development Bank, please refer to its Annual Report for the year ended June 30, 2000, or to its Annual Report for the year ended June 30, 2001, when it becomes available, copies of which may be obtained by calling or writing to Director - New York Office, Government Development Bank for Puerto Rico, 140 Broadway, 38<sup>th</sup> Floor, New York, NY 10005, telephone number (212) 422-6420 or to Director - Public Finance Department, Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, PR 00940, telephone number (787) 722-4170.

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**TABLE FOR ACCRETED VALUES FOR CAPITAL APPRECIATION BONDS  
(per \$5,000 Maturity Amount)**

Valuation Date	Series C Capital Appreciation Bonds due August 1,					
	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
December 27, 2001	\$2,659.05	\$2,505.20	\$2,360.25	\$2,223.65	\$2,095.00	\$1,973.80
February 1, 2002	2,674.05	2,519.35	2,373.55	2,236.20	2,106.85	1,984.90
August 1, 2002	2,754.95	2,595.55	2,445.35	2,303.85	2,170.55	2,044.95
February 1, 2003	2,838.30	2,674.05	2,519.35	2,373.55	2,236.20	2,106.85
August 1, 2003	2,924.15	2,754.95	2,595.55	2,445.55	2,303.85	2,170.55
February 1, 2004	3,012.60	2,838.30	2,674.05	2,519.35	2,373.55	2,236.20
August 1, 2004	3,103.75	2,924.15	2,754.95	2,595.55	2,445.35	2,303.85
February 1, 2005	3,197.60	3,012.60	2,838.30	2,674.05	2,519.35	2,373.55
August 1, 2005	3,294.35	3,103.75	2,924.15	2,754.95	2,595.55	2,445.35
February 1, 2006	3,394.00	3,197.60	3,012.60	2,838.30	2,674.05	2,519.35
August 1, 2006	3,496.70	3,294.35	3,103.75	2,924.15	2,754.95	2,595.55
February 1, 2007	3,602.45	3,394.00	3,197.60	3,012.60	2,838.30	2,674.05
August 1, 2007	3,711.45	3,496.70	3,294.35	3,103.75	2,924.15	2,754.95
February 1, 2008	3,823.70	3,602.45	3,394.00	3,197.60	3,012.60	2,838.30
August 1, 2008	3,939.35	3,711.45	3,496.70	3,294.35	3,103.75	2,924.15
February 1, 2009	4,058.55	3,823.70	3,602.45	3,394.00	3,197.60	3,012.60
August 1, 2009	4,181.30	3,939.35	3,711.45	3,496.70	3,294.35	3,103.75
February 1, 2010	4,307.80	4,058.55	3,823.70	3,602.45	3,394.00	3,197.60
August 1, 2010	4,438.10	4,181.30	3,939.35	3,711.45	3,496.70	3,294.35
February 1, 2011	4,572.35	4,307.80	4,058.55	3,823.70	3,602.45	3,394.00
August 1, 2011	4,710.65	4,438.10	4,181.30	3,939.35	3,711.45	3,496.70
February 1, 2012	4,853.15	4,572.35	4,307.80	4,058.55	3,823.70	3,602.45
August 1, 2012	5,000.00	4,710.65	4,438.10	4,181.30	3,939.35	3,711.45
February 1, 2013	-	4,853.15	4,572.35	4,307.80	4,058.55	3,823.70
August 1, 2013	-	5,000.00	4,710.65	4,438.10	4,181.30	3,939.35
February 1, 2014	-	-	4,853.15	4,572.35	4,307.80	4,058.55
August 1, 2014	-	-	5,000.00	4,710.65	4,438.10	4,181.30
February 1, 2015	-	-	-	4,853.15	4,572.35	4,307.80
August 1, 2015	-	-	-	5,000.00	4,710.65	4,438.10
February 1, 2016	-	-	-	-	4,853.15	4,572.35
August 1, 2016	-	-	-	-	5,000.00	4,710.65
February 1, 2017	-	-	-	-	-	4,853.15
August 1, 2017	-	-	-	-	-	5,000.00

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**\$40,750,000**  
**Puerto Rico Public Finance Corporation**  
**2001 Series D Bonds**  
**(Commonwealth Appropriation Bonds)**

Puerto Rico Public Finance Corporation (the "Corporation") is issuing its 2001 Series D Bonds (the "2001 Series D Bonds") to fund, together with the proceeds of the Corporation's 2001 Series C Bonds and 2001 Series E Bonds (collectively, the "Series 2001 Bonds"), the purchase of certain promissory notes (the "Notes") issued in connection with the restructuring of certain outstanding loans made by Government Development Bank for Puerto Rico ("Government Development Bank") to certain departments, agencies, instrumentalities and public corporations of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico"). Among the loans being restructured are certain loans (the "AFASS Loans") made by Government Development Bank to the Health Facilities and Services Administration, known in Spanish as Administración de Facilidades y Servicios de Salud de Puerto Rico ("AFASS"). AFASS provided a wide variety of services, including the operation and administration of public hospitals and other health facilities designed to promote the public welfare and make quality health services more accessible to the population, particularly to low income families and communities. The AFASS Loans include a line of credit (the "Line of Credit") provided by the Government Development Bank to AFASS to fund certain costs associated with the implementation of Puerto Rico's health reform program. On June 30, 1999, AFASS was dissolved and its obligations were assumed by the Puerto Rico Department of Health (the "Department of Health"). As successor by law to AFASS, the Department of Health will issue a promissory note (the "Health Department Note") in connection with the restructuring of the outstanding balance of the Line of Credit. The Series D Bonds are being issued for the sole purpose of funding the purchase of the Health Department Note. The term "Notes" includes the Health Department Note. The 2001 Series C Bonds and the 2001 Series E Bonds are being offered in separate Official Statements and are expected to be delivered on or about December 27, 2001 and January 16, 2002, respectively.

The Series 2001 Bonds are limited obligations of the Corporation payable solely from payments of principal of and interest on the Notes. The Notes are payable solely from budgetary appropriations to be made pursuant to legislation approved by the Legislature of Puerto Rico, signed by the Governor and presently pending its official publication (the "Act"). The Act requires the Office of Management and Budget to include in the operating budget of the Commonwealth submitted annually to the Legislature of the Commonwealth an amount not to exceed \$225 million to be used to pay the principal of and interest on the Notes and any loans covered by the Act which are held by Government Development Bank as they become due and payable. If the budgetary appropriations provided for under the Act are made on a timely basis each year and in the required amounts, payments required to be made under the Notes will at all times be sufficient to pay the principal of and interest on the Series 2001 Bonds as they become due and payable. The Legislature of Puerto Rico is not legally bound to appropriate funds for such payments.

The 2001 Series D Bonds will have the following characteristics:

- Interest on the 2001 Series D Bonds will be payable monthly on the first day of each month, commencing on February 1, 2002. Interest will accrue from the date of issuance of the 2001 Series D Bonds.
- The inside cover page contains information respecting the maturities, interest rates and prices of the 2001 Series D Bonds.
- Under most circumstances, interest on the 2001 Series D Bonds will be exempt from Puerto Rico and United States taxes to residents of Puerto Rico. Interest on the 2001 Series D Bonds is not excludable from gross income for federal income tax purposes under Section 103(a) of the United States Internal Revenue Code. See "Tax Matters" beginning on page 13 of this Official Statement.

The 2001 Series D Bonds are expected to be delivered on or about December 27, 2001.

The 2001 Series D Bonds will not constitute an obligation of the Commonwealth or any of its political subdivisions or public instrumentalities (other than the Corporation), and neither the Commonwealth nor any of its political subdivisions or public instrumentalities (other than the Corporation) will be liable thereon. The Corporation has no taxing power.

*Joint Lead Managers*

**Santander Securities**

**UBS PaineWebber Incorporated of Puerto Rico**

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**Popular Securities**

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**BBVA Capital Markets**  
**Oriental Financial Services**

**Doral Securities**  
**Prudential Securities Incorporated**

**Morgan Stanley**  
**Salomon Smith Barney**

**\$40,750,000**  
**Puerto Rico Public Finance Corporation**  
**2001 Series D Bonds**  
**(Commonwealth Appropriation Bonds)**

<b>Maturity Date</b>			
<b><u>August 1,</u></b>	<b><u>Principal Amount</u></b>	<b><u>Interest Rate</u></b>	<b><u>Price</u></b>
2003	\$ 1,250,000	3.70%	100%
2004	2,000,000	4.30	100%
2005	17,500,000	4.75	100%
2006	20,000,000	5.00	100%

No dealer, broker, sales representative or other person has been authorized by the Corporation or the Underwriters to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the Corporation or the Underwriters. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the 2001 Series D Bonds by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. The delivery of this Official Statement at any time does not imply that the information contained herein is correct as of any time subsequent to its date. The information set forth herein has been obtained from the Corporation, the Commonwealth and other official sources that are believed to be reliable. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Corporation or the Commonwealth since the date hereof. The Underwriters have provided the following three sentences for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

**IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE 2001 SERIES D BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.**

There is currently no secondary market for the 2001 Series D Bonds and there can be no assurance that a secondary market will develop or, if it does develop, that it will provide holders of the 2001 Series D Bonds with liquidity for their investment or that it will continue for the life of the 2001 Series D Bonds.

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**\$40,750,000**  
**Puerto Rico Public Finance Corporation**  
**2001 Series D Bonds**  
**(Commonwealth Appropriation Bonds)**

**INTRODUCTORY STATEMENT AND PLAN OF FINANCE**

This Official Statement of Puerto Rico Public Finance Corporation (the "Corporation"), a subsidiary of Government Development Bank for Puerto Rico ("Government Development Bank"), provides certain information in connection with the sale of Puerto Rico Public Finance Corporation 2001 Series D Bonds (the "2001 Series D Bonds").

This Official Statement incorporates by reference (i) the Comprehensive Annual Financial Report of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") for the Fiscal Year ended June 30, 2000, prepared by the Department of the Treasury of Puerto Rico (the "Commonwealth's Annual Financial Report"), which report includes the general purpose financial statements of the Commonwealth as of and for the Fiscal Year ended June 30, 2000, which have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report accompanying the financial statements; and (ii) the Commonwealth's Financial Information and Operating Data Report dated September 25, 2001 (the "Commonwealth Report"). The Commonwealth's Annual Financial Report has been filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR"). The Commonwealth Report is incorporated by reference from the Official Statement of the Commonwealth, dated October 11, 2001, relating to the issuance by the Commonwealth of its \$455,000,000 Public Improvement Bonds of 2002, Series A and its \$837,960,000 Public Improvement Refunding Bonds, Series 2002 A, which has been filed by the Commonwealth with each NRMSIR and with the Municipal Securities Rulemaking Board (the "MSRB"). Any appendix of an official statement of the Commonwealth or of any instrumentality of the Commonwealth containing the Commonwealth's Annual Financial Report or the Commonwealth Report filed with each NRMSIR and the MSRB or any other document containing the Commonwealth's Annual Financial Report or the Commonwealth Report filed with each NRMSIR after the date hereof and prior to the termination of the offering of the 2001 Series D Bonds shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained in any of the above described documents incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any subsequently filed document modifies or supersedes such statement. Any statement contained herein shall also be deemed to be modified or superseded to the extent that a statement contained in any subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

For information on how to obtain the Commonwealth's Annual Financial Report and the Commonwealth's Report, see "Miscellaneous."

The Commonwealth expects to complete the preparation of its Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2001, which will include the Commonwealth's general purpose financial statements as of and for the Fiscal Year ended June 30, 2001, together with the report thereon of the independent auditors, during the first calendar quarter of 2002. Upon completion thereof, the Commonwealth will file such Comprehensive Annual Financial Report with each NRMSIR and will make such report available to any person to whom this Official Statement is delivered upon request therefor in the manner specified below under "Miscellaneous".

The 2001 Series D Bonds are being issued under a trust agreement to be dated the date of issuance of the 2001 Series D Bonds (the "Trust Agreement"), between the Corporation and The Bank of New York, as trustee (the "Trustee").

Concurrently with the issuance of its 2001 Series D Bonds, the Corporation will issue under the Trust Agreement its 2001 Series C Bonds and will subsequently issue its 2001 Series E Bonds in the principal amounts of \$771,274,288.85 and \$1,095,845,000, respectively. The 2001 Series C Bonds, the 2001 Series D Bonds and the 2001 Series E Bonds (collectively, the "Series 2001 Bonds") are being issued for the purpose of providing the Corporation with the necessary funds to purchase from Government Development Bank several promissory notes (the "Series 2001 Notes") issued in connection with the restructuring and refinancing of certain loans made by Government Development Bank to certain departments, agencies, instrumentalities and public corporations of the Commonwealth (the "Authorized Debtors") pursuant to the terms of legislation approved by the Legislature of Puerto Rico, signed by the Governor of Puerto Rico and presently pending its official publication (the "Act"). All loans made by Government Development Bank to Authorized Debtors which are covered by the Act are referred to herein as the "Loans". Among the Loans being restructured pursuant to the Act are certain loans (the "AFASS Loans") made by the Government Development Bank to the Health Facilities and Services Administration, known in Spanish as Administración de Facilidades y Servicios de Salud de Puerto Rico ("AFASS"). The AFASS Loans include a line of credit (the "Line of Credit") provided by Government Development Bank to AFASS to fund certain costs associated with the implementation of Puerto Rico's health reform program. On June 30, 1999, AFASS was dissolved and its obligations were assumed by the Puerto Rico Department

of Health (the "Department of Health"). As successor by law to AFASS, the Department of Health will issue a promissory note (the "Health Department Note") in connection with the restructuring of the outstanding balance of the Line of Credit. The Series D Bonds are being issued for the sole purpose of funding the purchase of the Health Department Note. The terms "Series 2001 Notes" and "Loans" include the Health Department Note and the AFASS Loans, respectively. See "Source of Payment and Security for the Bonds - The Act, the Notes and the Loans". The 2001 Series C Bonds and the 2001 Series E Bonds are being offered in separate Official Statements.

The Series 2001 Notes will evidence the indebtedness of those Authorized Debtors, including the Department of Health, as successor by law to AFASS that, pursuant to the Act, will have restructured and refinanced their Loans with Government Development Bank as of the dates of delivery of the Series 2001 Bonds. Those Loans that are not restructured and refinanced with the Series 2001 Notes will continue to be held by Government Development Bank until additional bonds are issued by the Corporation under the Trust Agreement to fund the purchase of notes issued in connection with the restructuring of such Loans. As of June 30, 2001, the aggregate amount of principal and interest due on all Loans was approximately \$2.4 billion. The approved budget for Fiscal Year 2001-02 included an appropriation in respect of the Loans in the amount of approximately \$218 million. After this appropriation is applied to the payment of principal of and interest on the Loans, the aggregate principal due on all Loans will be approximately \$2.3 billion. Of this amount, approximately \$1.85 billion is being refinanced with the proceeds of the Series 2001 Bonds and the balance of approximately \$480 million will continue to be held by Government Development Bank.

The Series 2001 Bonds and any additional bonds issued in the future under the Trust Agreement are herein collectively referred to as the "Bonds". Additional Bonds may be issued under the Trust Agreement only to (i) fund the purchase of additional notes covered by the Act representing additional Loans that have been restructured and refinanced (such notes, together with the Series 2001 Notes, being referred to collectively as the "Notes"), (ii) refund any Bonds Outstanding under the Trust Agreement, (iii) fund a Reserve Account, if applicable, and (iv) pay the cost of issuance of such additional Bonds. See "Source of Payment and Security for the Bonds-Limitation on Additional Bonds."

The Bonds are limited obligations of the Corporation payable solely from Pledged Revenues (as defined in the Trust Agreement), consisting of payments of principal of and interest on the Notes and other amounts deposited to the credit of the Sinking Fund established under the Trust Agreement (the "Sinking Fund"), including the investment earnings therefrom. Payments of principal and interest under the Notes will be made solely from Legislative Appropriations to be made pursuant to the Act. The Act requires the Office of Management and Budget to include in the operating budget of the Commonwealth submitted annually to the Legislature of the Commonwealth the amounts necessary, up to a maximum of \$225 million per Fiscal Year, to pay the principal of and interest on the Notes and the Loans as they become due. If the Legislative Appropriations provided for under the Act are made on a timely basis each year and in the required amounts, payments of principal and interest required to be made under the Series 2001 Notes will at all times be sufficient to pay the principal of and interest on the Series 2001 Bonds as they become due and payable. The Legislature of Puerto Rico is not legally bound to appropriate funds for such payments. See "Source of Payment and Security for the Bonds."

This Official Statement, including information incorporated in this Official Statement by reference, contains certain "forward-looking statements" concerning the Commonwealth's operations and financial condition. These statements are based upon a number of assumptions and estimates which are subject to significant uncertainties, many of which are beyond the control of the Commonwealth. The words "may," "would," "could," "will," "expect," "anticipate," "believe," "intend," "plan," "estimate" and similar expressions are meant to identify these forward-looking statements. Actual results may differ materially from those expressed or implied by these forward-looking statements.

Descriptions of the Corporation, AFASS, the Commonwealth, the 2001 Series D Bonds, the Trust Agreement and certain other documents are included in this Official Statement. Such descriptions do not purport to be comprehensive or definitive. All references herein to the Trust Agreement and other documents are qualified in their entirety by reference to each such document. References herein to the 2001 Series D Bonds are qualified in their entirety by reference to the forms thereof. The resolution of the Corporation authorizing the issuance of the 2001 Series D Bonds (the "Resolution") and each of the aforesaid documents are available for inspection at the offices of the Corporation, located at Minillas Government Center, De Diego Avenue, San Juan, Puerto Rico 00940.

Capitalized terms not otherwise defined herein are defined in the Trust Agreement. See Appendix I - "Summary of the Trust Agreement."

## USE OF PROCEEDS

The net proceeds of the 2001 Series D Bonds (after payment of the costs of issuance hereinafter described) will be used to purchase the Health Department Note at a price equal to the principal amount thereof plus accrued interest. A portion of the proceeds of the 2001 Series D Bonds will be applied to the payment of expenses incident to the issuance thereof. The sources and uses of bond proceeds are set forth below.

**Sources:**

Initial Principal Amount of the 2001 Series D Bonds .....	<u>\$40,750,000.00</u>
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**Uses:**

Purchase of the Health Department Note .....	\$39,181,027.27
Capitalized Interest on the 2001 Series D Bonds through August 1, 2002 .....	1,167,191.67
Underwriting discount, legal, printing and other costs of issuance .....	401,781.06
 Total Uses .....	 <u>\$40,750,000.00</u>

## PUERTO RICO PUBLIC FINANCE CORPORATION

The Corporation is a subsidiary corporation of Government Development Bank created pursuant to Resolution No. 5044 of the Board of Directors of Government Development Bank, as amended ("Resolution No. 5044"), adopted pursuant to the authority granted under Act No. 17 of the Legislature of Puerto Rico, approved September 23, 1948, as amended. The Corporation is exempt from the payment of any Commonwealth taxes on its revenues and properties and constitutes an independent governmental instrumentality of the Commonwealth separate and apart from Government Development Bank. The obligations of the Corporation are not obligations of Government Development Bank. For additional information regarding the Corporation and Government Development Bank, see "Public Corporations - Government Development Bank for Puerto Rico" in the Commonwealth Report.

The Board of Directors of the Corporation consists of the same members of the Board of Directors of Government Development Bank, who are the following:

<u>Member</u>	<u>Occupation</u>	<u>Expiration Date</u>
Juan Agosto Alicea, Chairman	President, Government Development Bank for Puerto Rico	September 22, 2004
Melba Acosta Febo	Director, Office of Management and Budget	September 22, 2002
Ramón Cantero-Frau	Secretary of Economic Development and Commerce	September 22, 2002
Juan A. Flores Galarza	Secretary of the Treasury	September 22, 2002
Samuel H. Jové Fontán	President, BMJ Foods of Puerto Rico, Inc.	September 22, 2003
Fermín Contreras Bordallo	Private investor	September 22, 2003
Carmen Conde Torres	Attorney at law	September 22, 2004

The following individuals are currently officers of the Corporation:

*Juan Agosto Alicea*, President, is also President of Government Development Bank, a position he assumed in January of 2001. Prior to joining Government Development Bank this year, Mr. Agosto Alicea held various positions in government and in the private sector. From 1985 to 1988 he served as Secretary of the Treasury of Puerto Rico, and was Chairman of the Board of Directors of Government Development Bank. From 1995 to 1996 he was Administrator of the Municipality of San Juan. He worked for many years at two major accounting firms, and was the managing partner of one of these firms. He also worked at the Puerto Rico Industrial Development Company and the Federal Department of Housing and Urban Development. He obtained a bachelor's degree in accounting from the University of

Puerto Rico and is licensed as a certified public accountant since 1966. He is a former president of the Puerto Rico College of Certified Public Accountants and the Board of Directors of United Way of Puerto Rico.

*José V. Pagán*, Executive Vice President, is also Executive Vice President of Government Development Bank, a position he assumed in January of 2001. Prior to joining Government Development Bank this year, Mr. Pagán held various positions in investment banking and accounting firms during a 17 year period. Mr. Pagán also held the position of Executive Vice President of the Government Development Bank during 1992. Mr. Pagán received a bachelor's degree in engineering and applied science from Yale University, and a master's degree in finance from the New York University Graduate School of Business Administration.

*Miriam Figueroa*, Executive Vice President and General Counsel, is also Executive Vice President and General Counsel of Government Development Bank, a position she assumed in January of 2001. Prior to joining Government Development Bank, Ms. Figueroa worked as an attorney in private practice in New York and Tokyo, and in the United States Congress. Ms. Figueroa received a bachelor's degree from Macalester College, a law degree from the Pontifical Catholic University of Puerto Rico, and a master of law degree from Harvard Law School.

*Olga L. Ortiz*, Secretary of the Board of Directors, is also Secretary of the Board of Directors of Government Development Bank.

Pursuant to Resolution No. 5044, the Corporation has the authority, among other things, to issue bonds and other obligations for borrowed money payable out of all or any part of funds received in payment of the principal of and interest on securities of governmental instrumentalities of Puerto Rico purchased by the Corporation or any other funds or assets of the Corporation as provided by the resolution or trust agreement authorizing the issuance of its bonds.

As of November 2, 2001, the Corporation had bonds or notes outstanding in the aggregate principal amount of \$1.9 billion. All such bonds and notes, other than the Bonds, are payable from revenues other than the Pledged Revenues. Except for bonds which may be issued in the future to refund the Bonds, to purchase additional Notes covered by the Act, to fund a Reserve Account for one or more series of Bonds or to fund the costs of issuance of Bonds, the Corporation may not issue additional bonds payable from Pledged Revenues. The Corporation may from time to time issue additional bonds, which would be authorized and issued pursuant to trust indentures or authorizing resolutions separate from and unrelated to the Resolution and the Trust Agreement and would be secured with revenues other than the Pledged Revenues. See Appendix I - "Summary of the Trust Agreement—Additional Bonds - Refunding Bonds."

## HEALTH FACILITIES AND SERVICES ADMINISTRATION

### General

AFASS was created by Act No. 26 of November 13, 1975, as amended, for the purpose of carrying out the following functions: planning, evaluation and development of health services, alleviation of environmental contamination, operation of public hospitals and other health facilities, prevention and treatment of mental illness, and administration of family planning programs and maternal and child care activities. Prior to its dissolution in 1999, which is discussed below, AFASS provided a wide variety of services, including the operation and administration of public hospitals and other health facilities designed to promote the public welfare and make quality health services more accessible to the population, particularly to low income families and communities.

### The Line of Credit

The operations of AFASS were funded by appropriations from the Commonwealth and certain lines of credit provided by Government Development Bank, including the Line of Credit. The Line of Credit was established in 1997 by AFASS in the amount of \$200,000,000 to cover certain costs associated with the implementation of a comprehensive health care reform program that sought to change Puerto Rico's public health care system from one in which the government provided free health services to low income individuals through public health facilities owned and administered by the government to one in which all medical services are provided by the private sector and the government provides comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. More specifically, the Line of Credit was used to finance the health care insurance premiums due under the health care reform program. The Line of Credit was subsequently increased to \$332,000,000. As of June 30, 2001, the outstanding balance in the Line of Credit was \$217,000,000.

### Dissolution of AFASS

Effective June 30, 1999, AFASS was dissolved and its administrative responsibilities were transferred to the Department of Health. Act No. 187 of the Legislature of Puerto Rico, approved on August 7, 1998, authorized the Secretary of Health to consolidate into the

Department of Health all the programs formerly conducted by AFASS and provides that all agreements and contracts of AFASS and claims to which it was subject shall remain valid and shall be honored by the Department of Health.

### **The Health Department Note**

The Health Department Note is being issued by the Department of Health, as successor by law to AFASS, to restructure part of the outstanding balance of the Line of Credit. The Corporation will use the net proceeds of the 2001 Series D Bonds exclusively to purchase the Health Department Note, to pay capitalized interest on the 2001 Series D Bonds and to pay certain costs of issuing the 2001 Series D Bonds.

## **THE 2001 SERIES D BONDS**

### **General**

The 2001 Series D Bonds are being issued as registered bonds without coupons and will be initially registered only in the name of Cede & Co., as nominee of The Depository Trust Company ("DTC"), New York, New York, which will act as securities depository for the 2001 Series D Bonds. The 2001 Series D Bonds will be available to purchasers in denominations of \$5,000 principal amount and any integral multiple thereof only under the book-entry system maintained by DTC through brokers and dealers who are, or act through, DTC Participants (as defined herein). Purchasers will not receive physical delivery of the 2001 Series D Bonds. So long as any purchaser is the Beneficial Owner (as defined herein) of a 2001 Series D Bonds, such purchaser must maintain an account with a broker or dealer who is, or acts through, a DTC Participant to receive payment of principal of and interest on such 2001 Series D Bonds. See "Book-Entry Only System" below.

The 2001 Series D Bonds are being issued pursuant to the Resolution and the Trust Agreement. The 2001 Series D Bonds will be issued in such aggregate principal amounts and will be stated to mature as set forth on the inside cover page of this Official Statement.

Interest on the 2001 Series D Bonds will accrue from their date of issue at the rates set forth on the inside cover page of this Official Statement, and will be payable monthly on the first day of each month, commencing on February 1, 2002, until their respective maturities.

Interest will be calculated on the basis of a 360-day year of twelve 30-day months.

### **The 2001 Series D Bonds not Subject to Redemption prior to Maturity**

The 2001 Series D Bonds are not subject to optional or mandatory redemption prior to maturity.

### **Book-Entry Only System**

The following information concerning DTC and DTC's book-entry system has been obtained from DTC. The Corporation, the Trustee and the Underwriters assume no responsibility for the accuracy thereof.

DTC will act as securities depository for the 2001 Series D Bonds. The 2001 Series D Bonds will be issued as fully registered bonds registered in the name of Cede & Co. (DTC's partnership nominee) or such other nominee as may be requested by an authorized representative of DTC. One fully registered bond will be issued for each maturity of the 2001 Series D Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

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

“Indirect Participants” and, together with the Direct Participants, the “Participants”). The rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchases of the 2001 Series D Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2001 Series D Bonds in DTC’s records. The ownership interest of each actual purchaser of a 2001 Series D Bond (a “Beneficial Owner”) will in turn be recorded in the Direct or Indirect Participants’ records. Beneficial Owners will not receive written confirmations from DTC of their purchases, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 2001 Series D Bonds will be accomplished by entries made in the books of Participants acting on behalf of the Beneficial Owners. Beneficial Owners will not receive definitive bonds representing their ownership interests in the 2001 Series D Bonds except in the event that use of the book-entry system for the 2001 Series D Bonds is discontinued.

To facilitate subsequent transfers, all 2001 Series D Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. The deposit of 2001 Series D Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2001 Series D Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such 2001 Series D Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

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

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the 2001 Series D Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Corporation as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the 2001 Series D Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption premium, if any, and interest payments on the 2001 Series D Bonds will be made to DTC or such other nominee as may be requested by DTC. DTC’s practice is to credit Direct Participants’ accounts, upon DTC’s receipt of funds and corresponding detailed information from the Corporation or the Trustee, on the payable date in accordance with their respective holdings shown on DTC’s records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in “street name”, and will be the responsibility of such Participant and not of DTC, the Corporation or the Trustee, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of the principal, redemption premium, if any, and interest to DTC is the responsibility of the Corporation and the Trustee. Disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

Each person for which a DTC Participant acquires an interest in the 2001 Series D Bonds, as nominee, may desire to make arrangements with such DTC Participant to receive a credit balance in the records of such DTC Participant, to have all communications to DTC which may affect such persons forwarded in writing by such DTC Participant, and to have notification made of all interest payments.

**The Corporation, the Trustee and the Underwriters will have no responsibility or obligation to DTC Participants, Beneficial Owners or other nominees of such Beneficial Owners for: (i) sending transaction statements; (ii) maintaining, supervising or reviewing the accuracy of any records maintained by DTC or any DTC Participant or other nominees of such Beneficial Owners; (iii) payment or the timeliness of payment by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owner, of any amount due with respect to the principal of or interest on the 2001 Series D Bonds; (iv) delivery or timely delivery by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owners, of any notice or other communication which is required or permitted under the terms of the Trust Agreement to be given to the registered owners of 2001 Series D Bonds; or (v) any consent given or any action taken by DTC or its nominee as the registered owner of the 2001 Series D Bonds.**

## **Discontinuance of the Book-Entry Only System**

DTC may discontinue providing its services as securities depository with respect to the 2001 Series D Bonds at any time by giving reasonable notice to the Corporation or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, definitive 2001 Series D Bonds will be printed and delivered.

The Corporation, in its sole discretion and without the consent of any other person, may terminate the services of DTC as securities depository with respect to the 2001 Series D Bonds. In such event, definitive 2001 Series D Bonds will be printed and delivered.

In the event that such book-entry only system is discontinued or the Corporation terminates the services of DTC as securities depository, the following provisions will apply: (i) payments of the principal of and the interest on the 2001 Series D Bonds will be made in lawful money of the United States of America; (ii) payments of principal will be made at the principal corporate trust office of the Trustee in New York, New York; (iii) interest on the 2001 Series D Bonds will be paid by check mailed to the respective addresses of the registered owners thereof as of the fifteenth day of the month immediately preceding the interest payment date as shown on the registration books of the Corporation maintained by the Trustee; (iv) the 2001 Series D Bonds will be issued only as registered bonds without coupons in denominations of \$5,000 principal amount or any multiple thereof; and (v) the transfer of the 2001 Series D Bonds will be registrable and the 2001 Series D Bonds may be exchanged at the principal corporate trust office of the Trustee in New York, New York upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

## **SOURCE OF PAYMENT AND SECURITY FOR THE BONDS**

### **General**

Under the Trust Agreement, the Corporation will pledge the Notes to the Trustee and create a first lien on the Pledged Revenues (as defined in the Trust Agreement) for the benefit of the holders of the Bonds.

The Bonds are payable solely from and are secured by the Pledged Revenues, consisting of payments of principal of and interest on the Notes required to be deposited to the credit of the Bond Service Account and Redemption Account established under the Trust Agreement, any other monies deposited to the credit of those Accounts, including investment earnings thereon, and the monies on deposit in the Surplus Account established under the Trust Agreement, including investment earnings thereon. See Appendix I - "Summary of the Trust Agreement—Sinking Fund and Accounts."

**The Bonds do not constitute an obligation of the Commonwealth or any of its political subdivisions or public instrumentalities (other than the Corporation), and neither the Commonwealth nor any of its political subdivisions or public instrumentalities (other than the Corporation) shall be liable thereon. The Corporation has no taxing power.**

### **The Act, the Notes and the Loans**

As of June 30, 2001, the aggregate amount of principal and interest due on all Loans to Authorized Debtors held by Government Development Bank totaled approximately \$2.4 billion. These Loans had been made by Government Development Bank for the purpose of funding, among other things, capital expenditures and operating deficits of the Authorized Debtors. Prior to the enactment of the Act, the Loans did not have an established source of repayment. The Legislature of Puerto Rico approved the Act in order to provide a source of repayment for these Loans and enable Government Development Bank to sell the Loans in the capital markets through bond issues of the Corporation.

The Act requires Authorized Debtors to negotiate and execute with Government Development Bank the agreements necessary to recognize, formalize, restructure and/or refinance the Loans and to finance all expenses incurred in connection therewith. The Act provides that the Commonwealth, through budgetary appropriations during the next thirty Fiscal Years, commencing with Fiscal Year 2001-2002, will pay the principal of and interest on the Loans as the same may be restructured and/or refinanced under the Act. The Act provides, however, that such budgetary appropriations shall not exceed \$225 million per Fiscal Year.

On each date of delivery of the Series 2001 Bonds, Government Development Bank and the Corporation will enter into Debt Restructuring and Assignment Agreements with certain Authorized Debtors whereby the Authorized Debtors will agree to restructure and refinance all or a portion of their corresponding Loans. Pursuant to such Debt Restructuring and Assignment Agreements, such Authorized Debtors will execute the Series 2001 Notes and the Corporation will issue the Series 2001 Bonds and apply the net proceeds therefrom to purchase the Series 2001 Notes from Government Development Bank, without recourse to Government Development Bank.

Among the Authorized Debtors which are required to restructure their Loans pursuant to the Act is the Department of Health, as successor by law to AFASS. On the date of delivery of the 2001 Series D Bonds, the Department of Health, as successor by law to AFASS, will enter into a Debt Restructuring and Assignment Agreement with Government Development Bank pursuant to which the Department of Health will issue the Health Department Note in connection with the restructuring of the outstanding balance of the Line of Credit. The Corporation will apply the net proceeds of the 2001 Series D Bonds to purchase the Health Department Note from Government Development Bank, without recourse to Government Development Bank, to pay capitalized interest on the 2001 Series D Bonds and to pay the costs of issuing the 2001 Series D Bonds.

The initial aggregate principal amount of the Series 2001 Notes will be equal to the initial aggregate principal amount of the Series 2001 Bonds and the interest payable on such Series 2001 Notes will be the same as the interest payable on the Series 2001 Bonds.

After the sale of the Series 2001 Notes to the Corporation, Government Development Bank will continue to hold certain Loans in the aggregate principal amount of approximately \$480 million. It is expected that such Loans will be restructured in the future and that the Corporation will issue additional Bonds to purchase additional Notes issued by the Authorized Debtors in connection with the restructuring of such Loans. Such additional Notes will be in a principal amount equal to the initial principal amount of the additional Bonds issued to purchase such Notes and will bear interest sufficient to cover the interest on the additional Bonds. After all the Loans have been restructured and sold to the Corporation as contemplated by the Act, the aggregate initial principal amount of the Notes will equal the aggregate initial principal amount of the Bonds and the aggregate interest payable under the Notes will equal the aggregate interest payable under the Bonds. Such additional Bonds issued to purchase additional Notes may be privately placed with and held by Government Development Bank or sold in public offerings.

Under the Debt Restructuring and Assignment Agreements, Government Development Bank has agreed that it will not restructure and refinance any Loan if as a result thereof the annual interest, principal and other payments required to be made by the Authorized Debtors under the Notes and Loans would exceed \$225 million per Fiscal Year.

Under the Notes, the Authorized Debtors are required to make on or before July 15 of each Fiscal Year, commencing July 15, 2002, payments thereunder equal to the sum of the following amounts, without duplication: (i) the interest on, principal of, redemption premium, if any, and Accreted Value of the Bonds which is due and payable in the Bond Year which begins during such Fiscal Year (whether at maturity, in connection with an Amortization Requirement, upon redemption or otherwise) less any amounts available in the Sinking Fund for the payment of such amounts in such Bond Year; (ii) any fees, expenses or other amounts becoming due and payable in such Bond Year to the provider (a "Facility Provider"), if applicable, of a credit facility or a liquidity facility (each a "Facility") under the agreement relating to such Facility or any amounts required to reimburse a Facility Provider for payments made under any such Facility in respect of the Bonds and not theretofore reimbursed; (iii) if applicable, all payments required to be made by the Corporation under any Swap Agreement (as defined in the Trust Agreement) (such payments being called the "Corporation Swap Payments") expected to be due and payable for such Bond Year (to the extent not already included in the portion corresponding to interest on the Bonds); (iv) any fees or reimbursement for expenses payable to the Trustee under the Trust Agreement; (v) if applicable, any amount then due by the Corporation to the Hedge Counterparty (as defined in the Trust Agreement) for breakage cost or other termination payment under the terms of any Swap Agreement; and (vi) any other amount becoming due and payable in such Bond Year in respect of the Bonds or becoming due and payable under the provisions of the Trust Agreement. See Appendix I - "Summary of the Trust Agreement." The aggregate principal and interest installments to be paid under the Notes will be sufficient to cover the aggregate principal amount of and the aggregate annual amount of interest payable on the Bonds, together with fees, expenses and other amounts payable by the Corporation or the Trustee with respect to the Bonds.

The Notes are payable solely from Legislative Appropriations to be made pursuant to the Act. The Act provides that (i) the Commonwealth shall honor, by means of budgetary appropriations, the payment of principal of and interest on the Notes and Loans, (ii) the Office of Management and Budget shall include in the operating budget of the Commonwealth submitted annually to the Legislature of Puerto Rico in each of the succeeding thirty Fiscal Years, commencing with Fiscal Year 2001-02, the amounts necessary to pay the principal of and interest on the Notes and Loans, up to a maximum annual amount of \$225 million per Fiscal Year, and (iii) the budgetary appropriations made thereunder may be used only for the payment of principal of and interest on the Notes and Loans and related costs, and are not subject to third party claims. The approved budget for Fiscal Year 2001-02 included an appropriation in respect of the Loans in the amount of approximately \$218 million. This amount is being applied by Government Development Bank to pay accrued interest on the Loans and to reduce the outstanding principal balance thereof.

The funds to be provided by the Commonwealth to make the payments required under the Notes and Loans are subject to and conditioned upon the appropriation of such funds by the Legislature of Puerto Rico in the annual budget of the Commonwealth. If all required annual Legislative Appropriations are made in full and all payments of principal and interest due under the Notes are timely paid, such payments will be sufficient to pay the principal of and interest on the Bonds as the same become due and payable, together with all

amounts payable under the Trust Agreement. **The failure to make annual Legislative Appropriations in the amounts required would cause a shortfall in the monies available under the Notes to pay principal and interest due on the Bonds.**

#### **Special Considerations - Bonds are Limited Obligations; Legislature Not Legally Bound to Appropriate; Investment of Funds**

The principal of, redemption premium, if any, and interest on the Bonds will be payable solely from the Legislative Appropriations made pursuant to the Act and other sources described above. **The Legislature of Puerto Rico is not legally bound to appropriate sufficient amounts to timely pay the principal of, redemption premium, if any, and interest due on the Bonds. There is no assurance that sufficient funds will be appropriated or otherwise made available to make such payments on the Bonds.** For a discussion of Puerto Rico's budgetary process, see "Budgetary Process and Payment of Commonwealth Obligations" below and the Commonwealth Report, which is incorporated herein by reference.

Bondholders have no legal recourse to require the Legislature of Puerto Rico to appropriate the funds necessary to timely pay the principal of, redemption premium, if any, and interest due on the Bonds.

Neither the Corporation nor the Commonwealth has ever defaulted on the payment of principal of or interest on any of its debt.

Pending their application for the payment of principal of and interest on the Bonds on the dates required, funds on deposit in the Sinking Fund (including funds representing the Legislative Appropriation) shall be invested by the Trustee as required by the Trust Agreement. Pursuant to the Trust Agreement, such funds may be invested, among other investments, in an investment agreement with a financial institution which has a long term debt rating in one of the three highest rating categories by Moody's and Standard & Poor's (without regards to any gradations within such categories). In addition, the portion of the proceeds of the 2001 Series D Bonds which will fund the payment of interest on such Bonds through August 1, 2002 may also be invested in an investment agreement with Government Development Bank. Losses incurred in connection with such investments may result in a shortfall in the monies available to pay principal and interest due on the Bonds. See Appendix I - "Summary of the Trust Agreement—Investment of Moneys."

#### **Letter of Credit**

Under the Commonwealth's Constitution, if the annual budget of capital expenditures and operating expenses of the Commonwealth for a Fiscal Year has not been adopted by June 30 of the preceding Fiscal Year, the budget for such preceding Fiscal Year is automatically renewed for the ensuing Fiscal Year, until a new budget for such succeeding Fiscal Year is approved by the Legislature of Puerto Rico and the Governor. This means that if the debt service on the Notes and the Loans held by Government Development Bank (if at such time not all Loans have been restructured and transferred to the Corporation as Notes in connection with the issuance of additional Bonds) for any Fiscal Year and, therefore, the annual budgetary appropriation for such Fiscal Year is less than the debt service on the Notes and such Loans in the immediately succeeding Fiscal Year, then in the case of a delay in the approval of the budget for such succeeding Fiscal Year, pending approval of the new budget, the budgetary appropriation that would carry over and be available to meet debt service on the Notes and such Loans for such succeeding Fiscal Year would be insufficient to meet the debt service on the Notes and such Loans. See "Budgetary Process and Payment of Commonwealth Obligations" below.

The maximum increase from one Fiscal Year to the next in the aggregate debt service on the Notes and any Loans remaining with Government Development Bank (the "Maximum Difference"), and thus, the maximum difference in the annual budgetary appropriation under the Act from one Fiscal Year to the next with respect to the payment of debt service on the Notes and such Loans as estimated by Government Development Bank based on its projected schedule of amortization of principal of such Loans, is approximately \$50,000,000.

To cover the risk that in any year during the term of the Bonds the budget is not adopted prior to June 30 and the budgetary appropriation that automatically carries over from the prior Fiscal Year may be insufficient to cover fully the debt service payments on the Bonds during the ensuing Bond Year, on the date of delivery of the 2001 Series C Bonds and 2001 Series D Bonds, Government Development Bank (in such capacity, the "Letter of Credit Bank"), will issue an irrevocable, transferable standby letter of credit (the "Letter of Credit") in favor of the Trustee solely for the benefit of the owners of the Bonds. The Letter of Credit will be in the stated amount of \$50,000,000, which amount represents the estimated Maximum Difference throughout the term of the Bonds, as discussed above. The Letter of Credit enables the Trustee to draw up to the full amount thereunder unless: (i) on or prior to the third Business Day immediately preceding August 1 of each Fiscal Year during the term of the Bonds it receives written notice from the Corporation to the effect that the operating budget of the Commonwealth for such Fiscal Year has been adopted and (ii) the Trustee has otherwise received funds representing the full amount of the principal and interest due with respect to the Bonds for the Bond Year commencing within such Fiscal Year. In connection with the issuance of additional Bonds, the Trustee may be required to consent to amendments to the Letter of Credit or release the Letter of Credit in exchange for a new letter of credit from Government Development Bank or another financial institution meeting the requirements of the Trust Agreement. Such successor letter of credit or amended Letter of Credit would be in a stated amount higher or

lower than the stated amount of the Letter of Credit to the extent the Maximum Difference increases or decreases as a result of the issuance of additional Bonds. See "Source of Payment and Security for the Bonds—Limitation on Additional Bonds."

The Letter of Credit will expire on August 15, 2030, subject to earlier termination upon a draw of the full amount thereunder which is not reinstated. The Letter of Credit will be reinstated in the amount of any drawing upon reimbursement to Government Development Bank of the full amount of such drawing. The Letter of Credit will not cover the risk that no appropriation is made by the Legislature of Puerto Rico under the Act for any particular Fiscal Year (or that an appropriation is made pursuant to the Act in an amount lower than the amount of debt service on the Notes due with respect to any particular Fiscal Year). If the budget for any particular Fiscal Year is adopted but no appropriation for the payment of the Notes is included in such budget, the Trustee may not make a draw under the Letter of Credit. The Letter of Credit will be issued pursuant to a Letter of Credit and Reimbursement Agreement, dated as of the date of issuance of the 2001 Series C Bonds and 2001 Series D Bonds, by and between the Corporation and the Letter of Credit Bank. Appendix IV sets forth certain information with respect to Government Development Bank.

The Trust Agreement permits the Corporation to substitute the Letter of Credit for a letter of credit in the same stated amount for a term at least as long as the original Letter of Credit, containing administrative provisions reasonably acceptable to the Trustee and issued by a bank, banking association or trust company whose long-term obligations are rated at the time of issuance of such letter of credit in one of the three highest rating categories (without regard to gradations in any such category) by Standard & Poor's and Moody's.

### **Flow of Funds**

Under the Trust Agreement the Corporation agrees to cause the Secretary of the Treasury to transfer to the Trustee, no later than July 15 of each Fiscal Year while the Bonds are Outstanding, funds representing the entire Legislative Appropriation needed for the payment of all amounts due in respect of the Notes (including principal of and interest on the Bonds) for the immediately succeeding Bond Year, for deposit in the Sinking Fund as described below.

Any Legislative Appropriation (or funds received in substitution therefor or with respect to the Notes, including any monies received pursuant to a draw under the Letter of Credit) and other funds received by the Trustee, including any Hedge Counterparty Swap Payments (other than monies received from draws made under any Credit Facility or Liquidity Facility, other than the Letter of Credit, which monies will be deposited in special subaccounts as provided in the Trust Agreement) for the payment of principal of and interest on the Bonds shall be deposited in the Sinking Fund in the following order:

first, to the credit of the Bond Service Account, such amount as may be required to make the total amount then to the credit of the Bond Service Account equal to the sum of (i) the amount of interest then or to become due and payable on the Bonds of each Series then Outstanding during the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received; and (ii) the amount of principal then or to become due and payable not later than July 31 of such Bond Year on the Serial Bonds of each Series then Outstanding;

second, to the credit of the Redemption Account, such amount as may be required to make the total amount then to the credit of the Redemption Account in the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received equal to the Amortization Requirement for such Bond Year for the term Bonds of each Series then Outstanding; and

third, to the credit of the Surplus Account, any remaining amount.

Under the Trust Agreement, the Trustee is required to make a draw under the Letter of Credit on the second Business Day immediately preceding August 1 of any Bond Year unless it receives written notice from the Corporation prior to such date to the effect that a budget for the Fiscal Year commencing on the preceding July 1 has been adopted or it has otherwise received funds representing the full amount of principal and interest due with respect to the Bonds for such Bond Year.

Upon the delivery of the 2001 Series C Bonds and 2001 Series D Bonds, the Trustee will deposit to the credit of the Bond Service Account the sum of \$28,025,717.92, which sum will be applied by the Trustee to the payment of interest on the 2001 Series C Bonds and 2001 Series D Bonds becoming due through August 1, 2002. Such sum will not be available to pay any other debt service on the Series 2001 Bonds.

## **No Acceleration of the Bonds**

The Bonds are not subject to acceleration upon the occurrence of an event of default or otherwise.

## **Limitation on Additional Bonds**

No additional bonds may be issued under the Trust Agreement except to (i) fund the purchase by the Corporation of additional Notes covered by the Act, (ii) refund any Bonds issued under the Trust Agreement, (iii) fund a Reserve Account, if applicable, (iv) pay the costs of issuance of such additional Bonds and (v) pay capitalized interest on such additional Bonds. All such additional Bonds will be issued on a parity with the Series 2001 Bonds and will be entitled to the same benefit and security under the Trust Agreement.

No additional Bonds may be issued unless the amounts of principal and interest payable under the Notes (assuming timely payments under the Notes) after the issuance of such additional Bonds are sufficient to pay the principal of and interest on all Bonds Outstanding after the issuance of such additional Bonds as the same become due, together with other amounts required to be paid by the Corporation with respect to the Bonds, any outstanding Credit or Liquidity Facility, if applicable, or under the Trust Agreement. In addition, no additional Bonds may be issued unless the Letter of Credit is amended or a successor letter of credit is issued in favor of the Trustee, if necessary, so that in either case the amount of the Letter of Credit or such successor letter of credit is not less than the estimated Maximum Difference after the issuance of such additional Bonds as certified by the Corporation. Any successor letter of credit must be issued by a bank, banking association or trust company whose long-term debt obligations are rated at the time of issuance of the letter of credit in any of the three highest rating categories (without regard to any gradations within any such category) by Standard & Poor's and Moody's.

## **Budgetary Process and Payment of Commonwealth Obligations**

The Fiscal Year of the Commonwealth begins on July 1 and ends on June 30 (references herein to a particular Fiscal Year are based on the year in which such Fiscal Year ends). The Governor is constitutionally required to submit to the Legislature of Puerto Rico an annual budget of capital improvements and operating expenses of the Commonwealth for the ensuing Fiscal Year. The annual budget is prepared by the Office of Management and Budget, working with the Planning Board, the Treasury Department, Government Development Bank and other government offices and agencies. Section 7 of Article VI of the Constitution of Puerto Rico provides: "The appropriations made for any Fiscal Year shall not exceed the total revenues, including available surplus, estimated for said Fiscal Year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

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

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

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 necessary to balance the budget, or make recommendations to the Legislature of Puerto Rico for new taxes, or take any other necessary action to meet the estimated deficiency, or authorize borrowings under provisions of existing legislation, or take action which involves a combination of such steps. 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 obligation and guaranteed debt); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain and certain commitments to protect the name, credit and good faith of the Commonwealth government; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purposes.

The Constitution of Puerto Rico provides that the public debt of the Commonwealth will constitute a first claim on available Commonwealth revenues. Public debt of the Commonwealth includes general obligation bonds and notes of the Commonwealth to which

the full faith, credit and taxing power of the Commonwealth are pledged and, according to opinions rendered by the Attorney General of the Commonwealth, also any payments required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public instrumentalities. The Bonds do not constitute public debt of the Commonwealth for purposes of the constitutional provision described above.

For a description of the public debt of the Commonwealth and a more detailed discussion of the Commonwealth Budget, see the Commonwealth Report, which is incorporated herein by reference.

### PRO FORMA PUBLIC SECTOR DEBT OF THE COMMONWEALTH

The following table presents a summary of the public sector debt of the Commonwealth (1) as of June 30, 2001, as adjusted for the issuance on August 2, 2001 of the Corporation's 2001 Series A and Series B Bonds in the aggregate principal amount of \$390,000,000 (the "Prior 2001 Bonds") and the issuance on October 25, 2001 of the Commonwealth's Public Improvement Bonds of 2002, Series A and Series B and its Public Improvement Refunding Bonds, Series 2002A in the aggregate principal amount of \$1,312,960,000 (collectively, the "2002 Bonds") and the refunding of the bonds refunded thereby, (2) as further adjusted for the issuance of the Corporation's Series 2001 Bonds, and (3) as further adjusted for the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2002 in the principal amount of \$501,565,000 (the "Forward Delivery Bonds") and the refunding of the bonds referred thereby. The Forward Delivery Bonds have been sold and are expected to be delivered in April 2002. The table should be read in conjunction with the information set forth in "Debt" in the Commonwealth Report.

#### Commonwealth of Puerto Rico Public Sector Debt\* (in thousands)

	June 30, 2001 As Adjusted by the Issuance of the Prior 2001 Bonds and the 2002 Bonds <sup>(1)</sup>	June 30, 2001 As Adjusted by the Issuance of the Prior 2001 Bonds, the 2002 Bonds and the Series 2001 Bonds <sup>(1)</sup>	June 30, 2001 As Adjusted by the Issuance of the Prior 2001 Bonds, the Series 2001 Bonds and the Forward Delivery Bonds <sup>(1)</sup>
Puerto Rico direct debt . . . . .	\$ 5,936,380	\$ 5,936,380 <sup>(2)</sup>	\$ 5,933,185 <sup>(2)</sup>
Municipal debt . . . . .	1,632,170	1,632,170	1,632,170
Public corporations debt			
Puerto Rico guaranteed debt . . . . .	603,334	603,334	603,334
Debt supported by Puerto Rico appropriations or taxes . . . . .	12,142,612	14,050,481	14,050,481
Other non-guaranteed debt . . . . .	<u>6,539,423</u>	<u>6,539,423</u>	<u>6,539,423</u>
Total public corporations debt . . . . .	<u>19,285,369</u>	<u>21,193,238</u>	<u>21,193,238</u>
Total public sector debt . . . . .	<u>\$26,853,919</u>	<u>\$28,761,788</u>	<u>\$28,758,593</u>

\* For a complete recital of all notes to this table, see "Public Sector Debt" under "Debt" in the Commonwealth Report.

<sup>(1)</sup> Adjusted to exclude the bonds refunded thereby, including bonds refunded with proceeds that are or will be invested in guaranteed investment contracts and that will be considered to be outstanding under their authorizing resolutions and for purposes of calculating the Commonwealth's debt limitation.

<sup>(2)</sup> Adjusted to exclude payments of principal made on July 1, 2001.

Source: Government Development Bank.

## TAX MATTERS

The following is a summary of the opinion of Pietrantoní Méndez & Álvarez LLP, Bond Counsel, regarding certain Puerto Rico tax and United States federal income tax consequences of the ownership of the 2001 Series D Bonds. This section does not purport to cover all of the Puerto Rico tax and United States federal income tax consequences arising from the purchase and ownership of the 2001 Series D Bonds. The following is based upon laws and regulations now in effect and is subject to change.

In the opinion of Bond Counsel, based on the laws of Puerto Rico now in force:

1. Interest on the 2001 Series D Bonds is exempt from Puerto Rico income and withholdings taxes, including the alternative minimum tax imposed by Section 1017 of the Puerto Rico Internal Revenue Code of 1994, as amended (the "P.R. Code");
2. The 2001 Series D Bonds are exempt from property taxes imposed by the Municipal Property Tax Act of 1991, as amended, and interest thereon is exempt from the municipal license tax imposed by the Municipal License Tax Act of 1974, as amended;
3. The transfer of the 2001 Series D Bonds by (i) gift will not be subject to gift tax under the P.R. Code in the case of donors who are residents of the Commonwealth at the time the gift is made and (ii) death will not be subject to estate tax under the P.R. Code in the case of a decedent who at the time of death was (x) a resident of Puerto Rico and (y) a United States citizen who acquired such citizenship solely by reason of birth or residence in Puerto Rico;
4. Gain realized from the sale or exchange of a 2001 Series D Bond will be subject to income tax under the P.R. Code to taxpayers subject to Puerto Rico income tax on such gains, including individuals residing in Puerto Rico and corporations and partnerships organized under the laws of the Commonwealth;
5. The 2001 Series D Bonds will be considered an obligation of an instrumentality of Puerto Rico for purposes of (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the P.R. Code applicable to certain involuntary conversions and (ii) the exemption from the surtax imposed by Section 1102 of the P.R. Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of Puerto Rico and certain other investments; and
6. Interest on the 2001 Series D Bonds constitutes "industrial development income" under Section 2(j) of the Puerto Rico Industrial Incentives Act of 1963, the Puerto Rico Industrial Incentives Act of 1978, the Puerto Rico Tax Incentives Act of 1987, and the Puerto Rico Tax Incentives Act of 1998, as amended (collectively, the "Acts"), when received by a holder of a grant of tax exemption issued under any of the Acts that acquired the 2001 Series D Bonds with "eligible funds", as such term is defined in the Acts.

The P.R. Code does not provide rules with respect to the treatment of the excess, if any, of the amount due at maturity of a 2001 Series D Bond over its initial offering price (the "Accretion Amount"). Under the current administrative practice followed by the Puerto Rico Department of the Treasury, the Accretion Amount is treated as interest.

Prospective owners of the 2001 Series D Bonds, including but not limited to financial institutions, should be aware that ownership of the 2001 Series D Bonds may result in having a portion of their interest and other expenses attributable to interest on the 2001 Series D Bonds disallowed as deductions for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

In the opinion of Bond Counsel, based on the provisions of the United States Internal Revenue Code of 1986, as amended (the "Code"), now in force:

1. Interest on the 2001 Series D Bonds received by, or "original issue discount" (within the meaning of the Code) accrued to, a corporation (i) organized under the laws of Puerto Rico, or (ii) otherwise constituting a foreign corporation under the Code, is not subject to income taxation under the Code provided such interest or "original issue discount" is not effectively connected, or treated as effectively connected, with or attributable to the conduct of a trade or business within the United States by such corporation;
2. Interest on the 2001 Series D Bonds received by, or "original issue discount" (within the meaning of the Code) accrued to, an individual who is a *bona fide* resident of Puerto Rico during the entire taxable year in which such interest is received or "original issue discount" is accrued will constitute gross income from sources within Puerto Rico and, therefore, is excludable from gross income for purposes of the Code pursuant to section 933(1) thereof;
3. Interest on the 2001 Series D Bonds is not excludable from the gross income of the recipient thereof for federal income tax purposes under Section 103(a) of the Code;

4. A person that is subject to income tax under the Code on its worldwide income will generally be subject to federal income tax on any gain realized upon the sale or exchange of the 2001 Series D Bonds. However, pursuant to Notice 89-40 issued by the United States Internal Revenue Service on March 27, 1989, gain on the sale or exchange of the 2001 Series D Bonds by an individual who is a *bona fide* resident of Puerto Rico during the entire taxable year will constitute Puerto Rico source income and, therefore, qualify for the exclusion provided in Section 933(1) of the Code, provided such 2001 Series D Bonds do not constitute inventory in the hands of such individual; and

5. The transfer of the 2001 Series D Bonds by death or gift will not be subject to estate or gift tax under the Code in the case of decedents or donors who, at the time of death or gift, are (i) residents of Puerto Rico and (ii) (x) United States citizens that acquired such citizenship solely by reason of birth or residence in Puerto Rico or (y) not United States citizens.

Prospective owners of the 2001 Series D Bonds should also be aware that the Code provides special rules for the taxation of shareholders of foreign corporations that qualify as "controlled foreign corporations", "personal holding companies", "foreign personal holding companies" or "passive foreign investment companies", as such terms are defined by the Code.

The opinion of Bond Counsel regarding the tax consequences under Puerto Rico law and the Code arising from ownership of, receipt or accrual of interest on, or disposition of the 2001 Series D Bonds is limited to the above.

### CONTINUING DISCLOSURE UNDERTAKING

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the Securities and Exchange Commission, the Corporation and the Commonwealth, as specifically stated hereinbelow, have agreed to provide or cause to provide the following:

1. The Commonwealth will provide to each NRMSIR and to any Commonwealth state information depository ("SID") core financial information and operating data for each Fiscal Year, including (i) its audited financial statements prepared in accordance with generally accepted accounting principles in effect from time to time and (ii) material historical quantitative data (including financial information and operating data) on the Commonwealth, and information as to revenues, expenditures, financial operations and indebtedness of the Commonwealth, generally consistent with the information contained in the Commonwealth Report. Such information is expected to be filed within 305 days after the end of each Fiscal Year.

2. The Corporation will file, in a timely manner, with each NRMSIR or with the MSRB and any SID notice of the failure by the Commonwealth to comply with paragraph 1 above and notice of the occurrence of any of the following events with respect to the 2001 Series C Bonds if, in the judgment of the Corporation or its agent, such event is material::

- a. principal and interest payment delinquencies;
- b. non-payment related defaults;
- c. unscheduled draws on debt service reserves reflecting financial difficulties;
- d. unscheduled draws on credit enhancements reflecting financial difficulties;
- e. substitution of credit or liquidity providers, or their failure to perform;
- f. adverse opinions or events affecting the tax-exempt status of the 2001 Series D Bonds;
- g. modifications to rights of the holders (including beneficial owners) of the 2001 Series D Bonds;
- h. bond calls;
- i. defeasances;
- j. release, substitution, or sale of property securing repayment of the 2001 Series D Bonds; and
- k. rating changes.

The Corporation may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of the Corporation, such other event is material with respect to the 2001 Series D Bonds, but the Corporation does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

Event (c) is included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. However, event (c) may not be applicable since the terms of the 2001 Series D Bonds do not provide for "debt service reserves." In addition, with respect to the following events:

Events (d) and (e). The Corporation does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the 2001 Series D Bonds, unless the Corporation applies for or participates in obtaining the enhancement.

Event (f). For information on the tax status of the 2001 Series D Bonds, see “Tax Matters.”

Event (h). The Corporation does not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if the terms, dates and amounts of redemption are set forth in detail in this Official Statement under “The 2001 Series D Bonds —2001 Series D Bonds not Subject to Redemption Prior to Maturity”, the only open issue is which 2001 Series D Bonds will be redeemed in the case of a partial redemption, notice of redemption is given to the Bondholders as required under the terms of the 2001 Series D Bonds, and public notice of the redemption is given pursuant to Securities Exchange Act of 1934 Release No. 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or 2001 Series D Bond purchases.

The Commonwealth expects to provide the information described in paragraph 1(ii) above by filing its first bond official statement that includes such information for the preceding Fiscal Year or, if no such official statement is issued by the 305-day deadline, by filing its Financial Information and Operating Data Report containing the information described in paragraph 1(ii) above by such deadline.

As of the date of this Official Statement, there is no Commonwealth SID, and the NRMSIRs are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's J.J. Kenny Repository, 55 Water Street, 45<sup>th</sup> Floor, New York, New York 10041; FT Interactive Data, Att: NRMSIR, 100 William Street, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Commonwealth and the Corporation acknowledge that their undertaking pursuant to the Rule described under this heading is intended to be for the benefit of the holders of the 2001 Series D Bonds, including Beneficial Owners, and shall be enforceable by any such holders or Beneficial Owners; provided that the right to enforce the provisions of this undertaking shall be limited to a right to obtain specific enforcement of the Corporation's or the Commonwealth's obligations hereunder, and any failure by the Corporation or the Commonwealth to comply with the provisions of this undertaking shall not be an event of default with respect to the 2001 Series D Bonds under the Trust Agreement. The Corporation further acknowledges that it has not failed to comply with any similar undertaking under the Rule for the last five years.

No bondholder or Beneficial Owner may institute any suit, action or proceeding at law or in equity (“Proceeding”) for the enforcement of the foregoing covenants (the “Covenants”) or for any remedy for breach thereof, unless such bondholder or Beneficial Owner shall have filed with the Corporation and the Commonwealth written notice of any request to cure such breach, and the Corporation or the Commonwealth, as applicable, shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in any Commonwealth court located in the Municipality of San Juan for the equal benefit of all bondholders or Beneficial Owners of the Outstanding 2001 Series D Bonds benefitted by the Covenants, and no remedy shall be sought or granted other than specific performance of any of the Covenants at issue. Notwithstanding the foregoing, no challenge to the adequacy of the information provided in accordance with the filings mentioned above may be prosecuted by any bondholder or Beneficial Owner except in compliance with the remedial and enforcement provisions contained in the Trust Agreement. Moreover, Proceedings filed by bondholders or Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Article 2 of Law No. 104 approved June 29, 1955, as amended (32 L.P.R.A. §3077), which governs the scope of legal actions against the Commonwealth and substantially limits the amount of monetary damages that may be granted against the Commonwealth.

The Covenants may only be amended if:

(1) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Corporation or the Commonwealth, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the 2001 Series D Bonds, after taking into account any amendments or change in circumstances; the amendment does not materially impair the interests of bondholders or Beneficial Owners, as determined by parties unaffiliated with the Corporation or the Commonwealth; and the amendment does not adversely affect the Trustee; or

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

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

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

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

## **UNDERWRITING**

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the 2001 Series D Bonds from the Corporation at an aggregate discount of \$255,734.94 from the initial public offering prices of the 2001 Series D Bonds set forth or derived from information set forth on the inside cover page hereof. The obligations of the Underwriters are subject to certain conditions precedent, and the Underwriters will be obligated to purchase all the 2001 Series D Bonds, if any 2001 Series D Bonds are purchased. The Underwriters may offer to sell the 2001 Series D Bonds to certain dealers and others at prices lower than the initial public offering prices, and such offering prices may be changed, from time to time, by the Underwriters.

## **LEGAL MATTERS**

The proposed form of opinion of Pietrantoní Méndez & Alvarez LLP, Bond Counsel, is attached as Appendix II to this Official Statement. Certain legal matters will be passed upon for the Underwriters by O'Neill & Borges, San Juan, Puerto Rico.

## **LEGAL INVESTMENT**

The 2001 Series D Bonds will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for domestic insurance companies.

## **GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

As required by Act No. 272 of the Legislature of Puerto Rico, approved May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the Corporation in connection with the 2001 Series D Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the 2001 Series D Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates participate in other financial transactions with Government Development Bank.

## **RATINGS**

Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies Inc. ("Standard & Poor's"), have assigned the 2001 Series D Bonds ratings of Baa3 and A-, respectively. These ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency. There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies, if in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of either of such ratings may have an adverse effect on the market prices of the 2001 Series D Bonds.

Such rating agencies were provided with materials relating to the Commonwealth and the 2001 Series D Bonds and other relevant information, and no application has been made to any other rating agency for the purpose of obtaining a rating on the 2001 Series D Bonds.

Attached as Appendix III are the descriptions published by Moody's and Standard & Poor's of its investment grade rating classifications.

## **MISCELLANEOUS**

The foregoing summaries of or references to the various acts, the 2001 Series D Bonds, the Trust Agreement, the Resolution, the Notes, the Debt Restructuring and Assignment Agreements, the Letter of Credit, the Act and the summaries of or references to the various acts contained in the Commonwealth Report incorporated by reference herein are made subject to all the detailed provisions thereof to which reference is hereby made for further information and do not purport to be complete statements of any or all of such provisions.



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## SUMMARY OF THE TRUST AGREEMENT

The following is a summary of certain provisions of the Trust Agreement. The statements contained herein do not purport to be complete and this summary is qualified in its entirety by reference to the Trust Agreement.

**Definitions of Certain Terms**

The following words and terms have the following meanings, unless the context otherwise requires. Words importing the singular number include the plural number in each case and vice versa, and words importing persons include firms and corporations.

**“Accreted Value”** shall mean with respect to any Capital Appreciation Bond or Capital Appreciation and Income Bond (i) as of any Valuation Date, the amount set forth for such date in the resolution authorizing such Capital Appreciation Bond or Capital Appreciation and Income Bond and (ii) as of any date other than a Valuation Date, the sum of (a) the Accreted Value on the preceding Valuation Date (or, if there is no preceding Valuation Date, the initial principal amount) and (b) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date (or from the original issue date if there is no preceding Valuation Date) and the denominator of which is the number of days from such preceding Valuation Date (or from the original issue date if there is no preceding Valuation Date) to the next succeeding Valuation Date and (2) the difference between the Accreted Values for such Valuation Dates (or between the initial principal amount and the Accreted Value on the first Valuation Date).

**“Act”** shall mean Act Number 164 of the Legislature of Puerto Rico, approved December 17, 2001.

**“Amortization Requirement”** shall mean, for the Term Bonds of any Series for any Bond Year, the principal amount fixed or computed for the retirement by purchase or redemption of Term Bonds in such Bond Year.

The Amortization Requirement for the Term Bonds of each Series shall be initially in the respective principal amounts for each Bond Year as fixed in a resolution of the Corporation adopted prior to the issuance of the Bonds of such Series, and the aggregate amount of such Amortization Requirements for the Term Bonds of such Series shall be equal to the aggregate principal amount of the Term Bonds of such Series.

If at the close of any Bond Year the total principal amount of Term Bonds of any Series retired by purchase or redemption, or called for redemption under the provisions of the Trust Agreement during such Bond Year, shall be in excess of the amount of the Amortization Requirement for the Term Bonds of such Series for such Bond Year, then the amount of the Amortization Requirement for the Term Bonds of such Series shall be reduced for such subsequent Bond Years in such amounts aggregating the amount of such excess as shall be determined by the President of the Corporation in an order filed with the Trustee on or before the fifteenth (15th) day of the August following the close of such Bond Year.

It shall be the duty of the Trustee, on or before the 15th day of each Bond Year, to compute the Amortization Requirement for the then current Bond Year for the Term Bonds of each Series then Outstanding. The Amortization Requirement for the then current Bond Year shall continue to be applicable during the balance of such current Bond Year and no adjustment shall be made therein by reason of Term Bonds purchased or redeemed or called for redemption during such current Bond Year.

**“Appreciated Value”** shall mean, with respect to any Capital Appreciation and Income Bond (i) up to the Interest Commencement Date set forth in the resolution of the Board providing for the issuance of such Bond, an amount equal to the Accreted Value of such Bond and (ii) as of any date of computation on and after the Interest Commencement Date, an amount equal to the Accreted Value of such Bond on the Interest Commencement Date.

**“Authorized Debtors”** shall mean the departments, agencies, instrumentalities and public corporations of the Commonwealth authorized to recognize, formalize, restructure and/or refinance their advances, repayment commitments, obligations and/or loans with Government Development Bank pursuant to the Act.

**“Board”** shall mean the Board of Directors of the Corporation as constituted from time to time and which shall be the Board of Directors of Government Development Bank as provided by Resolution Number Five Thousand Forty-Four (5044), adopted December twelve (12), nineteen hundred eighty-four (1984) by the Board of Directors of Government Development Bank, as amended, or, if said Board shall be abolished, the board or body succeeding to the principal functions thereof or to whom the powers of the Corporation shall be given by law.

**“Bond Year”** shall mean the period commencing on the first day of August of any year and ending on the last day of July of the following year.

**“Bondholder,” “Holder,” “holder,” “Holder of Bonds,” or “Owner”** or any similar term, shall mean any person who shall be the registered owner of any Outstanding Bond or Bonds.

**“Bonds” or “bonds”** shall mean the bonds of the Corporation issued under the provisions of the Trust Agreement.

**“Business Day”** means a day other than a Saturday, Sunday or a day on which banks in the City of New York, New York, or San Juan, Puerto Rico, are authorized or required by law or executive order to close or are otherwise closed to the public.

**“Capital Appreciation Bonds”** shall mean any Bonds the accruing interest on which is compounded periodically on each of the dates designated for compounding in the resolution authorizing said Bonds and payable in an amount equal to the then current Accreted Value only at the maturity, earlier redemption or other payment date therefor, all as so provided by such resolution, and which may be either Serial Bonds or Term Bonds.

**“Capital Appreciation and Income Bonds”** shall mean any Bonds the accruing interest on which is not paid prior to the Interest Commencement Date specified in the resolution authorizing such Bonds and the Appreciated Value for such Bonds is compounded periodically on the dates designated in such resolution prior to the Interest Commencement Date for such Capital Appreciation and Income Bonds, and which may be either Serial Bonds or Term Bonds.

**“Corporation”** shall mean Puerto Rico Public Finance Corporation, a governmental instrumentality of the Commonwealth of Puerto Rico and a wholly-owned subsidiary of Government Development Bank for Puerto Rico.

**“Corporation Swap Payments”** means the net payments required to be made by the Corporation to the Hedge Counterparty under a Rate Swap (if applicable).

**“Credit Facility”** shall mean an irrevocable letter of credit, policy of municipal bond insurance, guaranty, purchase agreement, credit agreement or similar facility in which the person providing such facility irrevocably agrees to provide funds to make payment of the principal of, premium, if any, and interest on Bonds to which such Credit Facility relates.

**“Fiscal Year”** shall mean the period commencing on the first day of July of any year and ending on the last day of June of the following year or any other twelve month period designated by the Board.

**“GDB Letter of Credit”** shall mean the irrevocable transferable stand-by letter of credit issued by Government Development Bank in favor of the Trustee solely for the benefit of the Bondholders on the date of issue of the Corporation’s 2001 Series C Bonds and 2001 Series D Bonds.

**“Government Development Bank”** shall mean Government Development Bank for Puerto Rico.

**“Government Obligations”** shall mean (i) direct obligations of, or obligations the timely payment of principal of and the interest on which is unconditionally guaranteed by, the United States Government, (ii) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, any of the following: Banks for Cooperatives, Federal Farm Credit Banks, Federal Home Loan Banks, Export-Import Bank of the United States, Federal Financing Bank, Government National Mortgage Association, Farmer’s Home Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Housing Administration, and which obligations are rated at the time of purchase in the highest rating category by both Moody’s and Standard & Poor’s, (iii) all other obligations issued or unconditionally guaranteed as to principal and interest by an agency or instrumentality controlled or supervised by and acting as an instrumentality of the United States Government pursuant to authority granted by the Congress, which obligations are rated at the time of purchase in the highest rating category by both Moody’s and Standard & Poor’s and (iv) receipts evidencing the ownership of payments of principal of or interest on any of such obligations, which receipts are rated in the highest rating category by both Moody’s and Standard & Poor’s.

**“Hedge Counterparty”** means the provider of any Rate Swap with respect to the Bonds as counterparty under a Swap Agreement which provider must have a rating with respect to its long-term unsecured debt which is rated in one of the three highest rating categories (without regard to any gradation within such category) by Standard & Poor’s or Moody’s.

**“Hedge Counterparty Swap Payments”** means the net payments required to be made by a Hedge Counterparty to the Corporation under a Rate Swap.

**“Interest Commencement Date”** shall mean, with respect to any Capital Appreciation and Income Bond, the date specified in the resolution providing for the issuance of such Bond after which interest accruing on such Bond shall be payable on a periodic basis, with the first such payment date being the applicable Interest Payment Date immediately succeeding such Interest Commencement Date.

**“Interest Payment Dates”** shall mean the dates on which interest on a Series of Bonds or portion thereof is scheduled to be due and payable, as is provided by a resolution of the Board adopted prior to the issuance of such Series of Bonds.

**“Interim Bonds”** shall mean any Bonds issued on an interim basis that are expected to be repaid from the proceeds of Bonds or other indebtedness.

**“Investment Agreement”** shall mean any agreement for the investment of moneys entered into by the Trustee with a Qualified Financial Institution or collateralized at all times by Government Obligations having a market value at least equal to the principal amount of such agreement, as to which collateral the Trustee has a perfected first priority security interest, which collateral is held by the Trustee or its agent free and clear of claims by third parties and which collateral will result in the agreement being rated in the highest rating category by both Moody’s and Standard & Poor’s.

**“Investment Obligations”** shall mean (i) Government Obligations, (ii) time deposits, certificates of deposit or similar arrangements with, or banker’s acceptances issued by, any bank, banking association or trust company, including the Trustee, which is a member of the Federal Deposit Insurance Corporation having a combined capital and surplus aggregating not less than \$150,000,000 and reported deposits of not less than \$250,000,000, (iii) repurchase agreements with banks mentioned in (ii) above, including the Trustee, or with primary government dealers having a

capital and surplus in excess of \$150,000,000, with respect to any of the securities mentioned in (i) above, provided such securities are on deposit with the Trustee (or any duly appointed agent of the Trustee) and such agreements are structured as sale - purchase agreements rather than secured loans, (iv) obligations issued by the Commonwealth or any state or territory of the United States, which are rated in one of the three highest rating categories (without regard to any gradations within such category) by both Moody's and Standard & Poor's, (v) municipal obligations, the payment of the principal of and the interest on which is insured, which are rated in one of the three highest rating categories (without regard to any gradations within such category) by both Moody's and Standard & Poor's, (vi) commercial paper rated, or backed by a letter of credit or line of credit the provider of which is rated, in the highest rating category (without regard to any gradations within such category) by both Moody's and Standard & Poor's, (vii) an Investment Agreement, (viii) money market accounts of any state, Commonwealth or federally chartered bank, banking association, trust company or subsidiary trust company, including the Trustee, that is rated or whose parent bank is rated in the highest short-term rating category or in the highest long-term rating category by Moody's or Standard & Poor's (without regard to any gradations within such category) or money market funds registered under the Investment Company Act of 1940, as amended, whose shares are registered under the Securities Act of 1933, as amended, and having a rating by Standard & Poor's of "AAAm-G" or "AAAm", (ix) units of beneficial interest in any non-arbitrage investment program pools created by Government Development Bank or any of its subsidiaries or affiliates, (x) any obligation permitted under the laws of the Commonwealth which are rated in one of the three highest rating categories (without regard to any gradations within such category) by both Moody's and Standard & Poor's, and (xi) any securities otherwise permitted as eligible collateral under Act No. 69 of the Legislature of Puerto Rico, approved August 14, 1991, as amended.

**"Legislative Appropriation"** shall mean the funds appropriated by the Legislature of Puerto Rico in the annual budget of capital improvements and operating expenses of the Commonwealth for any Fiscal Year for the payment of the Notes pursuant to the provisions of the Act or, in the case such budget of the Commonwealth for any Fiscal Year has not been approved by the commencement of such Fiscal Year, until such budget is approved, the funds representing the amounts which had been appropriated in the budget of the Commonwealth for the previous Fiscal Year for the payment of the Notes pursuant to the provisions of the Act in accordance with Article VI, Section 6 of the Constitution of the Commonwealth.

**"Liquidity Facility"** shall mean a letter of credit, policy of municipal bond insurance, guaranty, purchase agreement or similar facility in which the person providing such facility agrees to provide funds to pay the purchase price of Put Bonds upon their tender by the Holders of Put Bonds.

**"Loans"** shall mean the advances, repayment commitments, obligations and/or loans of the Authorized Debtors specified in the Act.

**"Maximum Difference"** shall mean the maximum increase from one Fiscal Year to the next in the aggregate debt service on the Notes and on the Loans remaining with Government Development Bank.

**"Moody's"** means Moody's Investors Service, Inc., a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Corporation.

**"Notes"** shall mean promissory notes of the Authorized Debtors executed in connection with the restructuring of Loans pursuant to the Act and purchased with the proceeds of any Series of Bonds and pledged to the Trustee pursuant to the Trust Agreement.

**"Outstanding"** when used with reference to the Bonds shall mean, as of any date of determination, all Bonds theretofore authenticated and delivered except:

- a) Bonds theretofore cancelled by the Trustee or delivered to the Trustee for cancellation;
- b) Bonds that are deemed paid and no longer outstanding, as provided in the Trust Agreement;
- c) Bonds paid or Bonds in lieu of which other Bonds have been issued pursuant to the provisions of the Trust Agreement relating to Bonds destroyed, mutilated, stolen or lost, unless evidence satisfactory to the Trustee has been received that any such Bond is held by a bona fide purchaser;
- d) Bonds tendered or deemed tendered, as provided in the resolution of the Board for any Series of Bonds; and
- e) for purposes of any consent or other action to be taken under the Trust Agreement by the Holders of a specified percentage principal amount of Bonds, Bonds actually known by the Trustee to be held by or for the account of the Corporation.

**“Pledged Revenues”** shall mean all of the Corporation’s right, title and interest in and to (i) all amounts paid and to be paid in respect of the Notes, (ii) all moneys and Investment Obligations on deposit to the credit of the Sinking Fund, (iii) the Hedge Counterparty Swap Payments, if any, and (iv) all investment earnings on the foregoing.

**“Put Bonds”** shall mean Bonds that by their terms may be tendered by and at the option of the Holder thereof for payment prior to the stated maturity thereof.

**“Qualified Financial Institution”** means the Federal National Mortgage Association, or any bank, trust company or national banking association, or a corporation subject to registration with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended, or any government securities dealer, insurance company or other financial institution, in each case whose unsecured obligations or uncollateralized long term debt obligations (or obligations guaranteed by its parent entity) shall at all times during the term of the Investment Agreement issued by such Qualified Financial Institution have been assigned a rating by Standard & Poor’s and Moody’s in one of the three highest rating categories (without regard to any gradations within any such category), or which has issued a letter of credit, contract or agreement in support of debt obligations which at all times shall have been so rated.

**“Rate Swap”** means any interest rate swap arrangement between the Corporation and a Hedge Counterparty pursuant to any Swap Agreement and related documentation.

**“Rating Agencies”** shall mean Standard & Poor’s and Moody’s.

**“Reimbursement Agreement”** shall mean any letter of credit and reimbursement agreement or other similar agreement to pay the amounts due to the provider of a Credit Facility or a Liquidity Facility between the Corporation and any provider of a Credit Facility or a Liquidity Facility.

**“Reimbursement Obligation”** shall mean all amounts payable by the Corporation to a provider of a Credit Facility or Liquidity Facility pursuant to its agreement with such provider, including any fees payable and expenses reimbursable to such provider.

**“Reimbursement Obligation Principal”** shall mean all Reimbursement Obligations of the Corporation to a provider of a Credit Facility or a Liquidity Facility other than the obligation to pay interest on amounts owing to the provider of such Credit Facility or Liquidity Facility under the agreement with the provider of such Credit Facility or Liquidity Facility.

**“Reserve Account”** shall mean the account of that name which may be established in the Sinking Fund.

**"Reserve Account Insurance Policy"** shall mean the insurance policy, surety bond or other evidence of insurance deposited to the credit of the Reserve Account in lieu of or in partial substitution for cash or securities on deposit therein, which policy, bond or other evidence of insurance constitutes an unconditional senior obligation of the issuer thereof. The issuer thereof shall be a municipal bond insurer whose senior debt obligations, ranking *pari passu* with its obligations under such policy, bond or other evidence of insurance, are rated, at the time of deposit for the credit of the Reserve Account, in any of the three highest rating categories (without regard to any gradations within any such category) by Moody's and Standard & Poor's.

**"Reserve Account Letter of Credit"** shall mean the irrevocable, transferable letter of credit deposited to the credit of the Reserve Account in lieu of or in partial substitution for cash or securities on deposit therein, which letter of credit constitutes an unconditional senior obligation of the issuer thereof. The issuer of such letter of credit shall be Government Development Bank or a banking association, bank or trust company or branch thereof whose senior debt obligations, ranking *pari passu* with its obligations under such letters of credit are rated at the time of deposit to the credit of the Reserve Account, in any of the three highest rating categories (without regard to any gradations within any such category) by Moody's and Standard & Poor's.

**"Serial Bonds"** shall mean the Bonds designated as serial bonds in the resolutions authorizing such Bonds.

**"Series"** shall mean all of the Bonds authenticated and delivered at one time on original issuance and pursuant to any resolution authorizing such Bonds as a separate Series of Bonds, or any Bonds thereafter authenticated and delivered in lieu of or in substitution for such Bonds pursuant to the Trust Agreement, regardless of variations in maturity, interest rate or other provisions.

**"Sinking Fund"** shall mean the "Puerto Rico Public Finance Corporation Act 164 Sinking Fund," a special fund created and designated pursuant to the Trust Agreement.

**"Standard & Poor's"** means Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, its successors, their assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "Standard & Poor's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Corporation.

**"Swap Agreement"** shall mean any Interest Rate Swap Agreement between the Corporation and a Hedge Counterparty related to the Bonds.

**"Term Bonds"** shall mean the Bonds designated as term bonds in the resolutions authorizing such Bonds.

**"Valuation Date"** shall mean, with respect to any Capital Appreciation Bond or Capital Appreciation and Income Bond, the date or dates set forth in the resolution authorizing such bonds on which Accreted Values are assigned to the Capital Appreciation Bonds or Capital Appreciation and Income Bonds.

**"Variable Rate Bonds"** shall mean Bonds issued with a variable, adjustable, convertible or similar interest rate that is not fixed in percentage at the date of issue for the term thereof.

### **Sinking Fund and Accounts**

A special fund is created under the Trust Agreement and designated the "Puerto Rico Public Finance Corporation Act 164 Sinking Fund" (the "Sinking Fund") to be held by the Trustee. There are created three separate accounts in the Sinking Fund designated "Bond Service Account," "Redemption Account," and "Surplus Account." If the resolution of the Board providing for the issuance of Bonds under the Trust Agreement requires that a Reserve Account be established, a separate account in the Sinking Fund designated "Reserve Account" is authorized to be created in accordance with such resolution. Subject to the terms and conditions set forth in the Trust Agreement, moneys held

to the credit of the Sinking Fund shall be held in trust and applied by the Trustee solely for the purposes set forth below and pending such application shall be subject to the lien and charge created pursuant to the Trust Agreement until paid out or transferred as provided therein.

The Corporation shall cause the Secretary of the Treasury of the Commonwealth to transfer to the Trustee, no later than July 15 of each Fiscal Year while the Bonds are Outstanding, funds representing the entire Legislative Appropriation for such Fiscal Year.

All funds received by the Trustee representing the Legislative Appropriations (or funds received in substitution therefor or in respect of the Notes, including any moneys received pursuant to a draw under the GDB Letter of Credit) and other funds received by the Trustee, including any Hedge Counterparty Swap Payments (other than any moneys received from draws made under any Credit Facility or Liquidity Facility, other than the GDB Letter of Credit, which moneys will be deposited in special subaccounts as provided below), shall be deposited in the Sinking Fund in the following order:

first, to the credit of the Bond Service Account, such amount as may be required to make the total amount then to the credit of the Bond Service Account equal to the sum of (i) the amount of interest then or to become due and payable on the Bonds of each Series then Outstanding during the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received and (ii) the amount of principal then or to become due and payable not later than July 31 of such Bond Year on the Serial Bonds of each Series then Outstanding;

second, to the credit of the Redemption Account, such amount as may be required to make the total amount then to the credit of the Redemption Account in the Bond Year commencing within the Fiscal Year with respect to which such Legislative Appropriation is made or such funds are received equal to the Amortization Requirement for such Bond Year for the Term Bonds of each Series then Outstanding; and

third, to the credit of the Surplus Account, any remaining amount.

In lieu of any required deposit or in substitution of moneys on deposit to the credit of the Reserve Account (if applicable), the Corporation may cause to be deposited to the credit of the Reserve Account a Reserve Account Insurance Policy or a Reserve Account Letter of Credit in an amount equal to such required deposit, which Reserve Account Insurance Policy or Reserve Account Letter of Credit shall be satisfactory in form and substance to the Trustee and shall be payable or available to be drawn upon, as the case may be (upon the giving of notice as required thereunder), on any payment date for the Bonds on which a withdrawal from the Reserve Account would be required under the Trust Agreement, and give the Trustee the right to draw on any Reserve Account Insurance Policy or Reserve Account Letter of Credit prior to the expiration thereof unless the Corporation has furnished a replacement Reserve Account Insurance Policy or Reserve Account Letter of Credit or has provided sufficient moneys to make the amounts then on deposit to the credit of the Reserve Account equal to the amount required therefor. If a disbursement is made under a Reserve Account Insurance Policy or a Reserve Account Letter of Credit, the funds thereafter becoming available for deposit to the credit of the Reserve Account shall be used by the Trustee to reinstate the amounts available to be drawn under such Reserve Account Insurance Policy or Reserve Account Letter of Credit in an amount at least equal to the amount being reimbursed to the provider of such Reserve Account Insurance Policy or Reserve Account Letter of Credit or, if such reinstatement is not available, to deposit to the credit of the Reserve Account moneys in the amount of the disbursement made under such Reserve Account Insurance Policy or Reserve Account Letter of Credit or a combination of such alternatives.

If the Corporation issues Variable Rate Bonds pursuant to the Trust Agreement, the assumptions for calculating interest for the current Bond Year to ensure a sufficient deposit for the payment of said interest shall be made on the basis established in the resolution authorizing the issuance of such Variable Rate Bonds.

If there is a Credit Facility or a Liquidity Facility issued by a provider in connection with the issuance of a Series of Bonds, any moneys received from draws under such Credit Facility or a Liquidity Facility shall be deposited in separate subaccounts in the Bond Service Account or the Redemption Account, as appropriate, and used to pay the principal of and interest on the Bonds secured thereby.

To the extent required by a resolution of the Board in connection with the issuance of any Series of Bonds, the Trustee shall establish one or more subaccounts within the Bond Service Account and the Redemption Account to segregate amounts paid under any of the Notes and make withdrawals from such subaccounts to make payments under any Series of Bonds designated in such resolution. Nothing in the foregoing sentence shall be deemed to affect the parity status of the Bonds.

#### **Withdrawals from Bond Service Account**

On each Interest Payment Date or as otherwise provided in the resolution of the Board authorizing the issuance of a Series of Bonds, the Trustee shall withdraw from the Bond Service Account and (1) remit by mail (or by wire transfer if so provided by resolution of the Board) to each Holder of Bonds the amounts required for paying interest upon such Bonds as such interest becomes due, and (2) set aside sufficient moneys for paying the principal of Serial Bonds as such principal becomes due.

#### **Withdrawals from Redemption Account**

Moneys held to the credit of the Redemption Account shall be applied to the retirement of Bonds as follows:

(a) Subject to the provisions of paragraph (c) below, the Trustee shall endeavor to purchase Bonds or portions of Bonds, whether or not such Bonds or portions shall then be subject to redemption, at the most advantageous price obtainable with reasonable diligence, such price not to exceed the principal of such Bonds plus the amount of the premium, if any, that would be payable on the next redemption date to the holders of such Bonds under the redemption provisions of the Trust Agreement if such Bonds or portions of Bonds should be called for redemption on such date from the moneys in the Sinking Fund. The Trustee shall pay the interest accrued on such Bonds or portions of Bonds to the date of delivery thereof from the Bond Service Account and the principal portion of such purchase price from the Redemption Account. No such purchase shall be made by the Trustee within the period of forty-five (45) days immediately preceding the date on which such Bonds are subject to call for redemption under the redemption provisions of the Trust Agreement except from moneys in excess of the amounts set aside or deposited for such redemption of Bonds;

(b) Subject to the provisions of paragraph (c) below, the Trustee shall call for redemption on each date on which Bonds are subject to redemption from moneys in the Sinking Fund such amount of Bonds or portions of Bonds then subject to redemption as, with the redemption premium, if any, will exhaust the moneys then held for the credit of the Redemption Account as nearly as may be; provided, however, that not less than \$100,000 principal amount of Bonds shall be called for redemption at any one time. Such redemption shall be made pursuant to the redemption provisions of the Trust Agreement. Prior to calling Bonds or portions of Bonds for redemption the Trustee shall withdraw from the Bond Service Account and from the Redemption Account (including moneys transferred from the Reserve Account (if applicable) to the credit of the Redemption Account) and set aside in separate accounts or deposit with the paying agents the respective amounts required for paying the interest on, and the principal and redemption premium, if any, of the Bonds or portions of Bonds so called for redemption;

(c) Moneys in the Redemption Account shall be applied by the Trustee in each Bond Year to the retirement of Bonds of each Series then Outstanding in the following order:

first, the Term Bonds of each such Series to the extent of the Amortization Requirement, if any, for such Bond Year for the Term Bonds of each such Series then Outstanding, plus the applicable premium, if any, and, if the amount available in such Bond Year shall not be sufficient therefor, then

in proportion to the Amortization Requirement, if any, for such Bond Year for the Term Bonds of each such Series then Outstanding, plus the applicable premium, if any;

second, any balance then remaining shall be applied to the purchase of any Bonds then Outstanding whether or not such Bonds shall then be subject to redemption, in accordance with the provisions of paragraph (a) above; and

third, any balance then remaining shall be applied to the retirement of Bonds of each Series as directed by the Corporation.

#### **Withdrawals from Surplus Account**

Moneys held to the credit of the Surplus Account shall be applied by the Trustee to make payments in the following order: (i) to make up any deficiency in the Bond Service Account and the Redemption Account; (ii) to pay the compensation of the Trustee and other amounts payable to the Trustee under the Trust Agreement upon the written request of the Corporation; (iii) to make Corporation Swap Payments (if applicable); (iv) to pay any fees and expenses payable to the providers of any Credit Facility, Liquidity Facility, Reserve Account Insurance Policy or Reserve Account Letter of Credit (if applicable); and (v) to reimburse or pay any provider of such facilities (if applicable) for any other amounts due under the agreement with such provider.

Any moneys held to the credit of the Surplus Account after all amounts described in the preceding paragraph required to be paid in respect of a Bond Year have been paid shall, upon the written request of the Corporation, be transferred to the credit of the Bond Service Account or the Redemption Account.

#### **Reserve Account**

If the resolution of the Board providing for the issuance of Bonds under the Trust Agreement requires that a Reserve Account be established, a separate account in the Sinking Fund designated "Reserve Account" is authorized to be created in accordance with said resolution, in which Reserve Account there shall be established separate subaccounts as provided in such resolution. In such event the Trustee shall, from the funds received by the Trustee in accordance with the Trust Agreement, prior to depositing any amounts to the credit of the Surplus Account, deposit to the credit of each subaccount within the Reserve Account such amount as may be required to make the amount then on deposit to the credit of each such subaccount equal to the amount established in such resolution of the Board. Any Reserve Accounts created under the Trust Agreement will be applicable to one or more Series of Bonds issued under the Trust Agreement as provided in the resolution of the Board authorizing any such Series.

#### **Additional Bonds**

Additional Bonds may be issued under and secured by the Trust Agreement, subject to certain conditions, at any time or times solely for the purpose of (i) purchasing any additional Notes from Government Development Bank, (ii) providing funds for refunding all or any part of the Outstanding Bonds of any one or more Series by payment at maturity or redemption at a selected redemption date or dates or combination of such payment at maturity and redemption, including the payment of any redemption premium thereon, (iii) making a deposit to a Reserve Account (if applicable), and (iv) paying the costs of issuance of such additional Bonds. No additional Bonds may be issued unless the amounts of principal and interest payable under the Notes after the issuance of such additional Bonds are sufficient to pay the principal of and interest on all Bonds Outstanding after the issuance of such additional Bonds, together with other amounts required to be paid by the Corporation with respect to the Bonds, any Credit Facility or Liquidity Facility relating thereto, any Corporation Swap Payments and the Trust Agreement. In addition, no additional Bonds may be issued unless the GDB Letter of Credit is amended or a successor letter of credit is issued in favor of the Trustee, if necessary, so that in either case the amount of the GDB Letter of Credit or such successor letter of credit is not less than the estimated Maximum Difference after the issuance of such additional Bonds as certified by the Corporation. Any successor letter of credit must be issued by a bank, banking association or trust company whose long-term debt

obligations are rated at the time of issuance of the letter of credit in any of the three highest rating categories (without regard to any gradations within any such category) by Moody's and Standard & Poor's.

### **Investment of Moneys**

Moneys held to the credit of the Bond Service Account and the Redemption Account (except any subaccounts established by one or more resolutions of the Board to segregate amounts received from a Credit Facility or a Liquidity Facility, which resolution or resolutions may provide for the investment of moneys deposited to the credit of any such subaccount) shall, as nearly as may be practicable, be continuously invested and reinvested, at the written direction of the Corporation, in (i) Government Obligations that shall mature, or that shall be subject to redemption by the holder thereof at the option of such holder, not later than the respective dates when moneys held for the credit of said accounts will be required for the purposes intended; or (ii) Investment Agreements pursuant to which funds would be available not later than the respective dates when moneys held for the credit of said accounts would be required for the purposes intended. Moneys held to the credit of the Surplus Account shall be continuously invested and reinvested at the written direction of the Corporation in any Investment Obligations selected by it. Moneys held to the credit of the Reserve Account (if applicable) shall, as nearly as may be practicable, be continuously invested and reinvested at the written direction of the Corporation in Investment Obligations that shall mature no later than the final maturity of the Bonds.

Obligations so purchased as an investment of moneys in any such fund or account shall be deemed at all times to be a part of such fund or account, and any investment earnings and profit or loss realized on the sale or maturity thereof, shall be credited or debited to such fund or account; provided, however, that if the required deposit to any account in the Sinking Fund has been made for the current Bond Year, the investment earnings on moneys held to the credit of such account shall be deposited to the credit of any other account of the Sinking Fund for which such required deposit has not been made, in the order required by the Trust Agreement, and thereafter shall be deposited to the credit of such account in the Sinking Fund as shall be directed by the Corporation.

### **No Impairment**

The Corporation covenants and agrees that, so long as any of the Bonds shall be Outstanding and so long as any of its other obligations under any Reimbursement Agreement (if applicable) or Swap Agreement (if applicable) shall remain unpaid, none of the Pledged Revenues will be used for any purpose other than as provided in the Trust Agreement, and that no contract or contracts will be entered into or any action taken by which the rights of the Trustee, the holders or such other parties secured by the Trust Agreement to such Pledged Revenues might be impaired or diminished.

### **Inclusion of Principal and Interest Requirement in Budget**

Each year while any Bonds are Outstanding, the Corporation shall file a timely request with the Director of the Office of Management and Budget of Puerto Rico to include in the annual budget of capital improvements and operating expenses of the Commonwealth for the next Fiscal Year the necessary Legislative Appropriation so that payments in respect of the Notes shall be sufficient to cover the principal and interest payable with respect to the Bonds and all other amounts payable in respect of the Bonds or payable under the Trust Agreement during the next Bond Year.

### **Enforcement of Remedies**

At the request of the holders of not less than 20% of the aggregate principal amount of Bonds then Outstanding, the Trustee shall proceed, subject to the Trustee's rights to indemnification under the Trust Agreement, to protect and enforce its rights and the rights of the holders under the laws of Puerto Rico or under the Trust Agreement, including all rights with respect to the Notes and the Pledged Revenues, provided, that the Trustee may not sell or otherwise dispose of the Notes.

## **Pro Rata Application of Funds**

If at any time the moneys in the Sinking Fund shall not be sufficient to pay the interest on or the principal of the Bonds as the same shall become due and payable, such moneys (except for any moneys obtained from a drawing on a Credit Facility, other than the GDB Letter of Credit, or Liquidity Facility (if applicable) and deposited in a separate subaccount which shall secure only one or more specified Series of Bonds or moneys deposited in any subaccount within the Reserve Account that secures only such specified Series of Bonds), together with any moneys then available or thereafter becoming available for such purpose, whether through the exercise of the remedies provided for in the Trust Agreement or otherwise, shall be applied as follows:

first, to the payment to the persons entitled thereto of all installments of interest then due and payable in the order in which such installments became due and payable and, if the amount available shall not be sufficient to pay in full any particular installment, then to the payment, ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in such Bonds;

second, to the payment to the persons entitled thereto of the unpaid principal of any of the Bonds which shall have become due and payable (other than Bonds called for redemption for the payment of which moneys are held pursuant to the provisions of the Trust Agreement) in the order of their due dates, with interest on such Bonds at the respective rates specified therein from the respective dates upon which such Bonds became due and payable, and, if the amount available shall not be sufficient to pay in full the principal of such Bonds due and payable on any particular date, together with such interest, then to the payment first of such interest, ratably, according to the amount of such interest due on such date, and then to the payment of such principal, ratably, according to the amount of such principal due on such date, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in such Bonds;

third, to the payment of the interest on and the principal of such Bonds, to the purchase and retirement of Bonds and to the redemption of Bonds, all in accordance with the provisions of the Trust Agreement;

fourth, to the payment of any amounts then due and owing to a provider of a Credit Facility or a Liquidity Facility (if applicable); and

fifth, to the payment of any amounts then due and payable to a Hedge Counterparty under a Swap Agreement (if applicable).

## **Supplemental Agreements Without Bondholders' Consent**

The Corporation and the Trustee may, without the consent or approval of, or notice to, any of the Bondholders, from time to time and at any time, enter into agreements supplemental to the Trust Agreement as shall not be inconsistent with the terms and provisions thereof, for the following purposes:

(a) to cure any ambiguity or formal defect or omission in the Trust Agreement or in any supplemental agreement or to correct or supplement any provision contained therein that may be defective or inconsistent with any other provisions contained therein; or

(b) to grant to or confer upon the Trustee for the benefit of the Bondholders any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Bondholders or the Trustee;  
or

(c) to add to the conditions, limitations and restrictions on the issuance of Bonds under the provisions of the Trust Agreement, other conditions, limitations and restrictions thereafter to be observed; or

(d) to add to the covenants and agreements of the Corporation in the Trust Agreement other covenants and agreements thereafter to be observed by the Corporation or to surrender any right or power therein reserved to or conferred upon the Corporation; or

(e) to permit the issuance of Bonds in coupon form, if the conditions precedent stated therein have been met; or

(f) to qualify the Bonds or any of the Bonds for registration under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended; or

(g) to qualify the Trust Agreement as an "indenture" under the Trust Indenture Act of 1939, as amended; or

(h) to make such changes as may be necessary to adjust the terms of the Trust Agreement so as to facilitate the issuance of Variable Rate Bonds, Capital Appreciation Bonds, Capital Appreciation and Income Bonds, Put Bonds, Interim Bonds and such other Bonds as may be marketable from time to time; or

(i) to make such changes as may be necessary to comply with the provisions of Puerto Rico law relating to the exclusion of interest on the Bonds from gross income thereunder; or

(j) to make such changes as may evidence the right and interest of an issuer of a Credit Facility or a Liquidity Facility that secures any Series of Bonds; or

(k) to make such changes as may be necessary to create a Reserve Account for any Bonds Outstanding.

#### **Modification with Consent of Holders of Majority of Bonds**

Subject to the terms and provisions contained in the Trust Agreement, and not otherwise, the holders of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding (or in case less than all of several Series of Bonds then Outstanding are affected by the proposed supplemental agreement, the holders of not less than a majority in principal amount of the Bonds of each Series so affected and Outstanding at the time the consent is given) shall have the right, from time to time, anything contained in the Trust Agreement to the contrary notwithstanding, to consent to and approve the execution by the Corporation and the Trustee of such agreement or agreements supplemental thereto as shall be deemed necessary or desirable by the Corporation for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Trust Agreement or in any supplemental agreement; provided, however, that nothing contained in the Trust Agreement shall permit, or be construed as permitting, without the consent of the holders of 100% of the Bonds Outstanding affected by the proposed supplemental agreement (a) an extension of the time for the payment of the principal of (other than as provided by the terms of an Extendible Maturity Bond) or the interest on any Bond, or (b) a reduction in the principal amount of any Bond or the redemption premium or the rate of interest thereon, or (c) the creation of any lien or a pledge of funds other than the lien and pledge created by the Trust Agreement, or (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, or (e) a reduction in the aggregate principal amount of the Bonds required for consent to such supplemental agreement or any waiver under the Trust Agreement.

#### **Amendments to the Notes**

The Trustee (as assignee of the Notes) may enter into, from time to time and at any time, such amendments to the Notes, in form satisfactory to the Trustee, as shall not be inconsistent with the terms and provisions thereof to (a) cure

any ambiguity or formal defect or omission in the Notes, provided such action shall not materially adversely affect the interests of the Bondholders, or (b) grant to or confer upon the Corporation or Trustee for the benefit of the Bondholders any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Corporation or Bondholders or the Trustee, or (c) provide for the substitution of any Notes for other notes of Authorized Debtors, provided that such substitution does not restrict, limit or reduce the obligation of the Authorized Debtors to make payments sufficient to pay the principal of and interest on the Bonds, or otherwise impair the security of the Bondholders of any Series of Bonds under the Trust Agreement, or (d) make any other change which, in the judgment of the Trustee, based upon an opinion of counsel, will not restrict, limit or reduce the obligation of the Authorized Debtors to make the payments under the Notes sufficient to pay the principal of or interest on the Bonds, or otherwise impair the security of the Bondholders under the Trust Agreement.

Except for amendments provided for in the preceding paragraph, the Trustee shall not enter into any amendment to the Notes unless notice of the proposed amendment shall have been given and the holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall have consented to and approved the execution thereof, all as provided for under "Modification with Consent of Holders of Majority of Bonds" above; and provided further that without the consent of all of the holders of the Bonds Outstanding affected by such change, no such amendment shall be entered into by the Trustee which would restrict, limit or reduce the obligations of the Authorized Debtors with respect to the Bonds.

### **Defeasance**

If all the Outstanding Bonds shall have been paid or deemed to have been paid as provided below and all amounts due and owing to any provider of a Credit Facility, Liquidity Facility or Rate Swap shall have been paid, then and in that case the right, title and interest of the Trustee under the Trust Agreement shall cease, terminate and become void, and such Bonds shall cease to be entitled to any benefit or security under the Trust Agreement. In such event, the Trustee shall transfer and assign to the Corporation all property then held by the Trustee, shall execute such documents as may be reasonably required by the Corporation to evidence such transfer and assignment and shall turn over to the Corporation any surplus in any account in the Sinking Fund.

Any Outstanding Bond shall be deemed to have been paid within the meaning and with the effect expressed in the Trust Agreement when the whole amount of the principal of and interest on such Bond shall have been paid or when (a) there shall have been deposited with the Trustee or another fiduciary institution acting as escrow agent for the holder of such Bond either moneys in an amount which shall be sufficient, or Government Obligations, which shall not contain provisions permitting the redemption thereof at the option of the issuer, the principal of and interest on which when due, and without any reinvestment thereof, will provide moneys which, together with the moneys, if any, deposited with or held by the Trustee available therefor, shall be sufficient, to pay when due the principal of and premium, if any, and interest due and to become due on such Bond on or prior to the redemption date or maturity date thereof, as the case may be, and (b) in the event such Bond does not mature and is not to be redeemed within the next succeeding sixty 60 days, the Corporation shall have given the Trustee irrevocable instructions to give, as soon as practicable, a notice to the holder of such Bond by first-class mail, postage prepaid, stating that the deposit of moneys or Government Obligations has been made with the Trustee or another fiduciary institution acting as escrow agent for the holder of such Bond and that such Bond is deemed to have been paid in accordance with the Trust Agreement and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal of and premium, if any, and interest on such Bond.

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## PROPOSED FORM OF OPINION OF BOND COUNSEL

December 27, 2001

Puerto Rico Public Finance Corporation  
San Juan, Puerto Rico

Ladies and Gentlemen:

We have examined Act No. 17 of the Legislature of Puerto Rico approved September 23, 1948, as amended, creating Government Development Bank for Puerto Rico ("Government Development Bank") as a public corporation and a governmental instrumentality of the Commonwealth of Puerto Rico (the "Commonwealth"), Resolution No. 5044, as amended, of Government Development Bank and other proofs submitted in connection with the creation by Government Development Bank of a subsidiary of Government Development Bank and an independent governmental instrumentality of the Commonwealth designated Puerto Rico Public Finance Corporation (the "Corporation").

We have also examined certified copies of the Resolution of the Board of Directors of the Corporation (the "Resolution") authorizing the execution and delivery of a Trust Agreement, dated December 27, 2001 (the "Trust Agreement"), by and between the Corporation and The Bank of New York, Trustee (the "Trustee"), and other proofs submitted relative to the authorization, issuance and sale of

**\$40,750,000**  
**PUERTO RICO PUBLIC FINANCE CORPORATION**  
**2001 SERIES D BONDS**

bearing interest at such rates, payable on such dates and maturing in such principal amounts, all as set forth in the Resolution and the Trust Agreement (the "2001 Series D Bonds").

The proceeds of the 2001 Series D Bonds are to be used by the Corporation to purchase from Government Development Bank a promissory note of the Puerto Rico Department of Health (the "Health Department Note") and pay expenses incurred in connection with the issuance of the 2001 Series D Bonds. The Corporation is also issuing its 2001 Series C Bonds concurrently with the issuance of the 2001 Series D Bonds and proposes to issue, on or about January 16, 2002, its 2001 Series E Bonds (collectively with the 2001 Series C Bonds and 2001 Series D Bonds, the "2001 Bonds") for the purpose of providing the Corporation with the necessary funds to purchase from Government Development Bank certain other promissory notes of certain departments, agencies, instrumentalities or public corporations of the Commonwealth (the "Authorized Debtors") specified in the Resolution (such notes, together with the Health Department Note, being collectively called the "2001 Purchased Notes").

Pursuant to the Trust Agreement, the Corporation is authorized to issue additional series of bonds from time to time to purchase from Government Development Bank additional promissory notes of Authorized Debtors (the "Additional Notes" and together with the 2001 Purchased Notes, the "Notes") and to refund the 2001 Bonds and any other such bonds issued under the Trust Agreement upon the terms and conditions set forth therein, and any such bonds will be on a parity with the 2001 Bonds and all other bonds issued under the Trust Agreement (all such additional series of bonds, together with the 2001 Bonds, being collectively called the "Bonds").

The principal of and the interest on the 2001 Bonds are payable solely from Pledged Revenues (as defined in the Trust Agreement), initially consisting of payments of principal of and interest on the 2001 Purchased Notes and other funds held by the Trustee under the Trust Agreement. Upon issuance of additional bonds under the Trust Agreement for the purpose of providing funds to purchase Additional Notes, the Pledged Revenues shall also include payments of principal of and interest on such Additional Notes purchased. The principal of and interest on the Notes is payable solely from annual appropriations made by the Legislature of Puerto Rico pursuant to Act No. 164 of the Legislature of Puerto Rico approved on December 17, 2001.

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

From such examination, we are of the opinion that:

- (a) Said Act No. 17, as amended, has been validly enacted and is in full force and effect, and said Resolution No. 5044, as amended, has been duly adopted and is in full force and effect, and the Corporation is a duly constituted and existing subsidiary corporation of Government Development Bank and an independent governmental instrumentality of the Commonwealth.
- (b) The Resolution has been validly and legally adopted.
- (c) As authorized by said Resolution No. 5044, as amended, and by the Resolution, the Trust Agreement has been duly executed and delivered.
- (d) The 2001 Series D Bonds have been duly authorized and issued, among other things, to provide funds for the purchase of the Health Department Note.
- (e) The 2001 Series D Bonds are valid and binding obligations of the Corporation, payable solely from Pledged Revenues (as defined in the Trust Agreement), consisting initially of payments of principal of and interest on the 2001 Purchased Notes and other funds held by the Trustee under the Trust Agreement.
- (f) The 2001 Series D Bonds do not constitute a debt of the Commonwealth, any of its public instrumentalities (other than the Corporation) or any of its municipalities or other political subdivisions, and neither the Commonwealth, any of its public instrumentalities (other than the Corporation) nor any of such municipalities or other political subdivisions are liable thereon.
- (g) Based on the laws of the Commonwealth now in force:

1. Interest on the 2001 Series D Bonds is exempt from Puerto Rico income and withholding taxes, including the alternative minimum tax imposed by Section 1017 of the Puerto Rico Internal Revenue Code of 1994, as amended (the "P.R. Code").

2. The 2001 Series D Bonds are exempt from property taxes imposed by the Municipal Property Tax Act of 1991, as amended, and interest thereon is exempt from the municipal license tax imposed by the Municipal License Tax Act of 1974, as amended.

3. The transfer of the 2001 Series D Bonds (i) by gift will not be subject to gift tax under the P.R. Code in the case of donors who are residents of the Commonwealth at the time the gift is made and (ii) by death will not be subject to estate tax under the P.R. Code in the case of a decedent who at the time of death was (x) a resident of Puerto Rico and (y) a United States citizen who acquired such citizenship solely by reason of birth or residence in Puerto Rico.

4. Gain realized from the sale or exchange of a 2001 Series D Bond will be subject to income tax under the P.R. Code to taxpayers subject to Puerto Rico income tax on such gains, including individuals residing in Puerto Rico and corporations and partnerships organized under the laws of the Commonwealth.

5. The 2001 Series D Bonds will be considered an obligation of an instrumentality of the Commonwealth for purposes of (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the P.R. Code applicable to certain involuntary conversions and (ii) the exemption from the surtax imposed by Section 1102 of the P.R. Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of the Commonwealth and certain other investments.

6. Interest on the 2001 Series D Bonds constitutes “industrial development income” under Section 2(j) of the Puerto Rico Industrial Incentives Act of 1963, the Puerto Rico Industrial Incentives Act of 1978, the Puerto Rico Tax Incentives Act of 1987, and the Puerto Rico Tax Incentives Act of 1998, as amended (collectively, the “Acts”), when received by a holder of a grant of tax exemption issued under any of the Acts that acquired the 2001 Series D Bonds with “eligible funds”, as such term is defined in the Acts.

(h) Based on the provisions of the United States Internal Revenue Code of 1986, as amended (the “Code”), now in force:

1. Interest on the 2001 Series D Bonds received by, or “original issue discount” (within the meaning of the Code) accrued to, a corporation (i) organized under the laws of the Commonwealth, or (ii) otherwise constituting a foreign corporation under the Code, is not subject to income taxation under the Code provided such interest or “original issue discount” is not effectively connected, or treated as effectively connected, with or attributable to the conduct of a trade or business within the United States by such corporation.

2. Interest on the 2001 Series D Bonds received by, or “original issue discount” (within the meaning of the Code) accrued to, an individual who is a *bona fide* resident of the Commonwealth during the entire taxable year in which such interest is received or “original issue discount” is accrued will constitute gross income from sources within the Commonwealth and, therefore, is excludable from gross income for purposes of the Code pursuant to Section 933(1) thereof.

3. Interest on the 2001 Series D Bonds is not excludable from the gross income of the recipient thereof for federal income tax purposes under Section 103(a) of the Code.

4. A person that is subject to income tax under the Code on its worldwide income will generally be subject to federal income tax on any gain realized upon the sale or exchange of the 2001 Series D Bonds. However, pursuant to Notice 89-40 issued by the United States Internal Revenue Service on March 27, 1989, gain on the sale or exchange of the 2001 Series D Bonds by an individual who is a *bona fide* resident of the Commonwealth during the entire taxable year will constitute Puerto Rico source income and, therefore, qualify for the exclusion provided in Section 933(1) of the Code, provided such 2001 Series D Bonds do not constitute inventory in the hands of such individual.

5. The transfer of the 2001 Series D Bonds by death or gift will not be subject to estate or gift tax under the Code in the case of decedents or donors who, at the time of death or gift, are (i) residents of Puerto Rico and (ii) (x) United States citizens that acquired such citizenship solely by reason of birth or residence in Puerto Rico or (y) not United States citizens.

The P.R. Code does not provide rules with respect to the treatment of the excess, if any, of the amount due at maturity of a Series D Bond over its initial offering price (the "Accretion Amount"). Under the current administrative practice followed by the Department of the Treasury of the Commonwealth, the Accretion Amount is treated as interest.

Prospective owners of the 2001 Series D Bonds, including but not limited to financial institutions, should be aware that ownership of the 2001 Series D Bonds may result in having a portion of their interest and other expenses attributable to interest on the 2001 Series D Bonds disallowed as deductions for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

Prospective owners of the 2001 Series D Bonds should also be aware that the Code provides special rules for the taxation of shareholders of foreign corporations that qualify as "controlled foreign corporations", "personal holding companies", "foreign personal holding companies" or "passive foreign investment companies", as such terms are defined by the Code.

Other than as described herein, we have not addressed, and we are not opining upon, the federal or Commonwealth income tax consequences to any investor arising from the ownership of, receipt or accrual of interest on, or disposition of the 2001 Series D Bonds.

Very truly yours,

**DESCRIPTIONS OF INVESTMENT GRADE RATINGS  
BY MOODY'S AND STANDARD & POOR'S**

**Description of Moody's Long Term Ratings**

The purpose of Moody's ratings is to provide investors with a simple system of gradation by which the relative investment qualities of bonds may be noted. There are nine basic rating categories for long-term obligations, ranging from Aaa (highest quality) to C (lowest quality). Moody's applies numerical modifiers 1, 2 and 3 in each generic rating classification from Aa to Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of the generic ratings category.

- Aaa** Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edged". Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.
- Aa** Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high-grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risks appear somewhat larger than in Aaa securities.
- A** Bonds which are rated A possess many favorable investment attributes and are to be considered as upper-medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment sometime in the future.
- Baa** Bonds which are rated Baa are considered as medium-grade obligations (i.e., they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

**Description of Standard & Poor's Municipal and Corporate Debt Ratings**

A Standard & Poor's issue credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program (including ratings on medium term note programs and commercial paper programs). It takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated.

The issue credit rating is not a recommendation to purchase, sell or hold a financial obligation, inasmuch as it does not comment as to market price or suitability for a particular investor.

The ratings are based on current information furnished by the obligors or obtained by Standard and Poor's from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any credit rating and may, on occasion, rely on unaudited financial information. Credit ratings may be changed, suspended or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances.

The ratings are based, in varying degrees, on the following considerations:

1. Likelihood of payment — capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation;

2. Nature of and provisions of the obligation;
3. Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

Investment grade:

- AAA** An obligation rated "AAA" has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is **EXTREMELY STRONG**.
- AA** An obligation rated "AA" differs from the highest-rated obligations only in small degree. The obligor's capacity to meet its financial commitment on the obligation is **VERY STRONG**.
- A** An obligation rated "A" is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still **STRONG**.
- BBB** An obligation rated "BBB" exhibits **ADEQUATE** protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

The following information has been obtained from Government Development Bank. Neither the Corporation nor the Underwriters have verified such information, and they shall have no liability with respect to such information.

Government Development Bank is a government instrumentality of the Commonwealth created by Act No. 17 of the Legislature of Puerto Rico, approved September 13, 1948, as amended. Government Development Bank's primary purpose is to act as fiscal agent for the Commonwealth and its public entities. In that capacity, Government Development Bank acts as fiscal agent in connection with all short-term borrowings and bond issues of the Commonwealth, its public corporations and municipalities. In addition, Government Development Bank makes loans to the Commonwealth, its public corporations and municipalities, and to the private sector.

As of June 30, 2000, Government Development Bank had total assets of \$8.3 billion, total deposits of \$3.5 billion and capital of \$1.6 billion. For the year ended June 30, 2000, it reported net income of \$102.5 million.

As of June 30, 2001, Government Development Bank had total assets of \$7.8 billion, total deposits of \$3.1 billion and capital of \$1.7 billion. For the year ended June 30, 2001, it reported net income of \$84.9 million.

The principal offices of Government Development Bank are located at Minillas Government Center, De Diego Avenue, Stop 2, Santurce, Puerto Rico. For more detailed information on Government Development Bank, please refer to its Annual Report for the year ended June 30, 2000, or to its Annual Report for the year ended June 30, 2001, when it becomes available, copies of which may be obtained by calling or writing to Director - New York Office, Government Development Bank for Puerto Rico, 140 Broadway, 38<sup>th</sup> Floor, New York, NY 10005, telephone number (212) 422-6420 or to Director - Public Finance Department, Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, PR 00940, telephone number (787) 722-4170.

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