

NEW ISSUE
Full-Book-Entry

RATINGS
Moody's: MIG - 1
S&P: SP - 1

(See "Book-Entry Only System" under *The Notes*)

In the opinion of Bond Counsel, under existing law and assuming compliance with the tax covenants described herein and the accuracy of certain representations and certifications made by the Commonwealth and described herein, interest on the Notes is excluded from gross income for Federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"). Bond Counsel is also of the opinion that such interest is not treated as a preference item in calculating the alternative minimum tax imposed under the Code with respect to individuals and corporations. Interest on the Notes is, however, included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations. Bond Counsel is further of the opinion that, under existing law, interest on the Notes is exempt from state, Commonwealth and local income taxation. See TAX MATTERS herein regarding certain other tax considerations.

\$800,000,000
COMMONWEALTH OF PUERTO RICO
Tax and Revenue Anticipation Notes
Series 2003

Dated: Date of Delivery
Due: July 30, 2003

Yield: 1.48%
Interest Rate: 2.50%

The Notes bear interest at the annual rate shown above, computed on the basis of twelve 30-day months and a 360-day year. Principal of and interest on the Notes are payable in immediately available funds at maturity. The Notes are not subject to redemption prior to maturity. The Notes are issuable in fully registered form in denominations of \$5,000 and any integral multiple thereof.

The Notes constitute direct obligations of the Commonwealth of Puerto Rico and are payable solely from taxes and revenues in the General Fund collected after the date of issuance of the Notes and on or prior to June 30, 2003, as described herein. The Secretary of the Treasury is required to deposit such taxes and revenues, in the manner set forth herein and after certain prior applications, in the Note Fund in an amount sufficient to provide for the payment of principal of and interest on the Notes. Moneys in the Note Fund are subject to prior application for the payment of the general obligation bonds and notes of the Commonwealth of Puerto Rico and bonds and notes of its public corporations guaranteed by the Commonwealth of Puerto Rico to the extent other moneys are not available for such purpose. Neither the full faith, credit and taxing power of the Commonwealth of Puerto Rico nor that of any of its political subdivisions are pledged for the payment of principal of or interest on the Notes.

The Notes are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Nixon Peabody LLP, New York, New York, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by O'Neill & Borges, San Juan, Puerto Rico. It is expected that settlement for the Notes, in immediately available funds, will occur in San Juan, Puerto Rico, on or about October 3, 2002.

Morgan Stanley	Banc of America Securities LLC	Salomon Smith Barney
ABN Amro Financial Services, Inc.	Bear, Stearns & Co., Inc.	Goldman, Sachs & Co.
Lehman Brothers	Merrill Lynch & Co.	UBS PaineWebber Inc.
		Wachovia Bank, National Association

September 25, 2002

Commonwealth of Puerto Rico

Governor

SILA M. CALDERÓN

Members of the Cabinet

CÉSAR MIRANDA
Chief of Staff

FERDINAND MERCADO
Secretary of State

ANABELLE RODRÍGUEZ
Secretary of Justice

JUAN A. FLORES GALARZA
Secretary of the Treasury

CÉSAR REY
Secretary of Education

VÍCTOR RIVERA HERNÁNDEZ
*Secretary of Labor and
Human Resources*

JOHNNY RULLÁN
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LUIS RIVERO CUBANO
Secretary of Agriculture

JOSÉ IZQUIERDO
*Secretary of Transportation
and Public Works*

RAMÓN CANTERO-FRAU
*Secretary of Economic
Development and Commerce*

YOLANDA ZAYAS
Secretary of Family Affairs

ILEANA ECHEGOYEN
Secretary of Housing

SALVADOR SALAS
*Secretary of Natural and
Environmental Resources*

JAVIER ECHEVARRÍA VARGAS
Acting Secretary of Consumer Affairs

JORGE ROSARIO
Secretary of Sports and Recreation

VÍCTOR RIVERA GONZÁLEZ
*Secretary of Corrections
and Rehabilitation*

Legislative Officers

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President, Senate

CARLOS VIZCARRONDO
Speaker, House of
Representatives

Fiscal Officers

MELBA ACOSTA
Director, Office of Management
and Budget

HÉCTOR MÉNDEZ-VÁZQUEZ
President, Government Development
Bank for Puerto Rico

No dealer, broker, sales representative or other person has been authorized by the Commonwealth of Puerto Rico 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 Commonwealth of Puerto Rico 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 Notes by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. The information set forth herein has been obtained from the Commonwealth of Puerto Rico and other official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness and is not to be construed as a representation by any Underwriter. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth of Puerto Rico since the date hereof. This Official Statement is submitted in connection with the sale of the Notes referred to herein and may not be reproduced or used, in whole or in part, for any other purpose. The Underwriters have provided the following sentence 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 PRICE OF THE NOTES AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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\$800,000,000
COMMONWEALTH OF PUERTO RICO
Tax and Revenue Anticipation Notes
Series 2003

INTRODUCTORY STATEMENT

This Official Statement sets forth certain information about the Commonwealth of Puerto Rico (the “Commonwealth” or “Puerto Rico”) and the \$800,000,000 Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series 2003 (the “Notes”).

The Notes are being issued under Act No. 1, approved by the Legislature of Puerto Rico on June 26, 1987 (the “Act”), and pursuant to a resolution adopted by the Secretary of the Treasury on September 25, 2002 (the “Note Resolution”), for the purpose of funding a portion of the projected cash flow requirements of the Commonwealth’s General Fund in fiscal 2003, which requirements result from timing differences between expected disbursements and receipts of taxes and revenues.

Without the issuance of the Notes, the Commonwealth estimates that the General Fund would incur monthly cash deficits which would reach a cumulative maximum deficit of approximately \$1 billion in November, 2002. For a breakdown of the General Fund cash flow, after taking into account the issuance of the Notes, see “General Fund Monthly Cash Flow for Fiscal 2002 and Fiscal 2003” under *Puerto Rico Taxes, Other Revenues and Expenditures*.

The Notes constitute direct obligations of the Commonwealth payable solely from the taxes and revenues in the General Fund collected by the Secretary of the Treasury after the date of issuance of the Notes and on or prior to June 30, 2003 and deposited in a special fund (the “Note Fund”) for the payment of principal of and interest on the Notes as more fully described herein. All moneys in the Note Fund required for such purpose shall be used to pay the principal of and the interest on the Notes at maturity and shall be used for no other purpose; provided, however, that pursuant to certain constitutional and statutory authorizations, payments on general obligation bonds and notes of the Commonwealth and on bonds and notes of its public corporations guaranteed by the Commonwealth have a claim on Commonwealth taxes and revenues, including amounts on deposit in the Note Fund, prior to the claim thereon of the Notes.

The Secretary of the Treasury covenants in the Note Resolution to compute, on a monthly basis, projected revenues, expenditures and fund balances of the General Fund, commencing in October 2002, in order to make certain debt service coverage calculations to ensure the full and timely payment of the Notes.

Neither the full faith, credit and taxing power of the Commonwealth nor that of any of its political subdivisions are pledged for the payment of principal of or interest on the Notes. The Commonwealth does not have any notes outstanding on a parity with the Notes, and the Secretary of the Treasury covenants in the Note Resolution not to issue any parity notes, except notes issued pursuant to the Act.

For a discussion of the security for the Notes, see “Payment of and Security for the Notes” under *The Notes*.

This Official Statement incorporates by reference (i) the Commonwealth’s Financial Information and Operating Data Report dated May 10, 2002 (the “Commonwealth Report”), which appears as Appendix I to the Official Statement of the Commonwealth, dated July 18, 2002, relating to the sale of its Public Improvement Bonds of 2003, Series A, and its Public Improvement Refunding Bonds, Series 2003; and (ii) the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 2001, prepared by the Department of the Treasury of Puerto Rico (the “Commonwealth’s Annual Financial Report”), which includes the general purpose financial statements of the Commonwealth as of and for the fiscal year ended June 30, 2001, which have been audited by KPMG LLP, independent auditors, as stated in their report dated January 21, 2002, accompanying the financial statements. KPMG LLP did not audit the financial statements of the pension trust funds, the public university funds, and certain activities and component units separately identified in their report. Those financial statements were audited by other auditors whose reports have

been furnished to KPMG LLP, and their opinion on the general purpose financial statements, insofar as it relates to the amounts included in the general purpose financial statements pertaining to such activities and component units, is based solely on the reports of the other auditors.

The Official Statement of the Commonwealth dated July 18, 2002, which includes the Commonwealth Report, was filed by the Commonwealth with the Municipal Securities Rulemaking Board (the "MSRB") and with each nationally recognized municipal securities information repository ("NRMSIR"). The Commonwealth's Annual Financial Report was filed by the Commonwealth with each NRMSIR. Any appendix of an Official Statement of the Commonwealth or of any instrumentality of the Commonwealth filed with each NRMSIR and the MSRB or any other document containing the same information as the Commonwealth Report, or any other document supplementing or amending the Commonwealth Report, filed with each NRMSIR after the date hereof and prior to the termination of the offering of the Notes shall also be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained herein or in any of the above described documents incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained in any other subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Commonwealth will provide without charge to any person to whom this Official Statement is delivered, on the written or oral request of such person, a copy of the Commonwealth's Annual Financial Report and of the Commonwealth Report. Copies of the Note Resolution are also available upon request from Government Development Bank for Puerto Rico ("Government Development Bank" or "GDB"). Requests should be directed to Director-General Obligations Division, Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, PR 00940, telephone number (787) 722-7060.

A copy of the Commonwealth's Annual Financial Report and of the Commonwealth Report may be obtained by contacting a NRMSIR. The address of each NRMSIR is set forth in *Continuing Disclosure*. The Commonwealth expects that its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2002, including its audited general purpose financial statements for such fiscal year, will be available to investors during the first quarter of calendar year 2003. Promptly after its release, said Report will be filed with and available from each NRMSIR.

This Official Statement, including information incorporated by reference in this Official Statement, 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," "could," "will," "expect," "anticipate," "believe," "intend," "plan," "estimate" and similar expressions are meant to identify these forward looking statements. Actual results may vary materially from those expressed or implied by these forward looking statements.

OVERVIEW

The following is a summary (updated with respect to certain matters) of certain information regarding the Commonwealth contained in the Commonwealth Report. This summary does not purport to be complete and is qualified in its entirety by reference to more detailed information appearing in the Commonwealth Report, which should be read in its entirety.

Puerto Rico is located approximately 1,600 miles southeast of New York City. According to the U.S. Census Bureau, Puerto Rico's population was 3,808,610 in 2000. Puerto Rico's political status is that of a commonwealth. The United States and the Commonwealth share a common defense, market, currency and citizenship. The Commonwealth government exercises virtually the same control over its internal affairs as is exercised by the state governments of each of the fifty states over their respective internal affairs, with similar separation of powers among the executive, legislative and judicial branches. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States, but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives but no vote.

Most federal taxes, except those such as Social Security taxes which are imposed by mutual consent, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries. The official languages of Puerto Rico are Spanish and English.

Economic Trends

During the two decades ended with fiscal year 2001, Puerto Rico's economy grew continuously, interrupted only by an economic slowdown during fiscal years 1991 and 1992. Almost every sector of the economy participated in this expansion and record levels of employment were achieved. Factors contributing to this expansion include government-sponsored economic development programs, periodic declines in the exchange value of the United States dollar, increases in the level of federal transfers, the relatively low cost of borrowing and low oil prices. Gross product increased from \$32.3 billion in fiscal 1997 (\$31.4 billion in 1996 prices) to \$44.2 billion in fiscal 2001 (\$35.3 billion in 1996 prices). This represents an increase of 36.7% from fiscal 1997 to 2001 (12.6% in 1996 prices). From fiscal year 1985 through fiscal year 2001 personal income, both aggregate and per capita, increased consistently. In fiscal year 2001, aggregate personal income was \$41.5 billion (\$37.2 billion in 1996 prices)¹ and personal income per capita was \$10,816 (\$9,713 in 1996 prices). According to the Labor Department's Household Employment Survey, average employment increased from 1,128,300 in fiscal 1997, to 1,158,200 in fiscal 2001. Average unemployment decreased from 13.1% in fiscal 1997 to 10.5% in fiscal 2001.

Macroeconomic figures for fiscal year 2002, which ended on June 30, 2002, will not be available until December 2002. (Puerto Rico does not report quarterly macroeconomic figures.) The Puerto Rico Planning Board's gross product forecast for fiscal 2002 and fiscal 2003, made in March 2002, projected an increase in real gross product of 0.3% for fiscal 2002 and 2.7% for fiscal 2003. However, various short-term monthly indicators show that the Puerto Rican economy in fact experienced a significant slowdown during fiscal year 2002 that could be characterized as a recession. These short-term trends could affect the Puerto Rican economy's actual growth rate during fiscal 2002 and 2003.

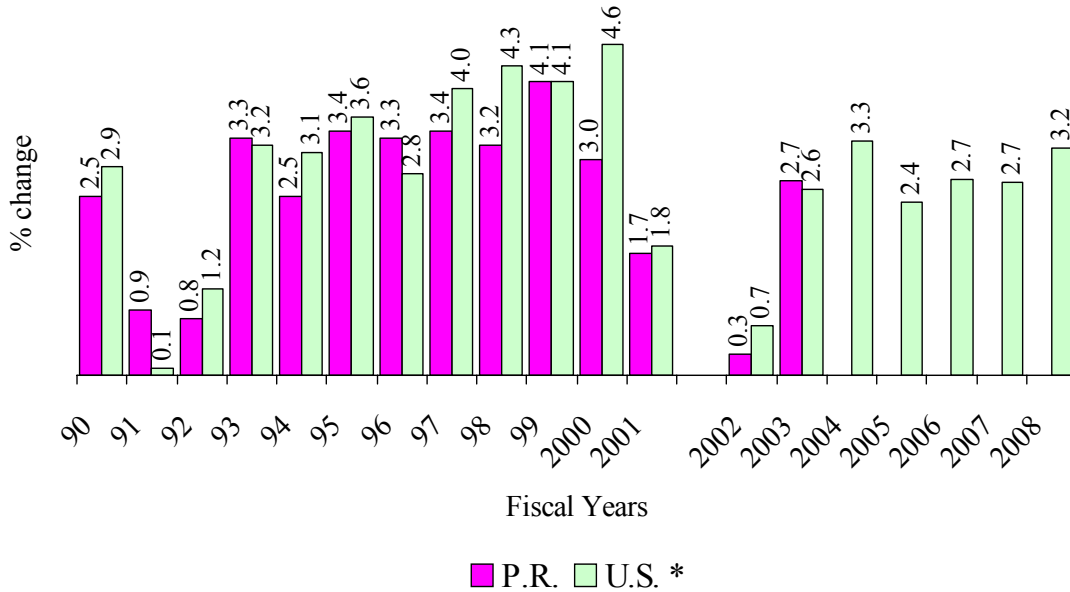
According to the Labor Department's Household Employment Survey, during fiscal 2002, total monthly employment averaged 1,169,700 compared to 1,158,200 in fiscal 2001, representing an increase of 1.0%. As a result of an increase in the labor participation rate which more than offset the increase in average monthly employment, there was an increase in the unemployment rate from 10.4% during fiscal 2001 to 12.0% during fiscal 2002. The seasonally adjusted unemployment rate for June 2002 was 12.8%.

As usual, exogenous factors had a significant impact on the performance of the Puerto Rican economy during fiscal 2002. Among these were the performance of the United States economy, the amount of federal transfer payments, the level of oil prices and interest rates.

In the past, Puerto Rico has been heavily dependent on oil imports for its energy needs. As a result of the construction of two cogeneration plants, however, one of which burns liquified natural gas and is now operational, and the other of which will burn coal and is expected to become operational during 2002, Puerto Rico's dependence on oil imports for its energy needs is expected to be reduced by approximately 30%. See "Other Public Corporations - Electric Power Authority" under *Public Corporations* in the Commonwealth Report.

1 Different price deflators are used for gross product and personal income statistics.

Real GNP Growth Rate



* DRI forecast as of September 2002 for information on the U.S. for fiscal years 2002 through 2008. Puerto Rico Planning Board forecast as of March 2002 for information on Puerto Rico for fiscal years 2002 and 2003.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Manufacturing is the largest sector in terms of gross domestic product. According to the Planning Board's figures, manufacturing generated \$27.1 billion, or 39.9%, of gross domestic product and accounted for 13.7% of total employment in fiscal 2001, as compared with fiscal 2000, when it generated \$23.4 billion, or 38.3%, of gross domestic product and accounted for 14.0% of total employment. See "Economic Performance by Sector" under *The Economy* in the Commonwealth Report. Manufacturing in Puerto Rico is now more diversified than during the earlier phases of its industrial development and includes several industries less prone to business cycles. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by the heavy investment in the pharmaceutical, scientific instruments, computers and electrical products industries in Puerto Rico over the last decade. One of the factors assisting the development of the manufacturing sector has been the tax incentives offered by the federal and Puerto Rico governments. Federal legislation enacted in 1996, however, which amended Section 936 of the Internal Revenue Code of 1986, phases out the federal tax incentives during a ten-year period. See "Tax Incentives - Incentives Under the Code" under *The Economy* in the Commonwealth Report.

The services sector, which includes hotel and related services and currently accounts for approximately 48.2% of total employment, generated \$26.8 billion, or 39.4%, of Puerto Rico's gross domestic product in fiscal 2001, as compared with \$24.8 billion, or 40.6%, of gross domestic product in fiscal 2000.

Growth in construction has also contributed to increased economic activity from fiscal 1997 through fiscal 2000. During that period, construction investment increased 44.9%, and in fiscal 2001 it remained at \$6.8 billion.

Tourism continues to make a significant contribution to economic activity. More than 4.9 million visitors spent \$2.7 billion in Puerto Rico in fiscal 2001. San Juan has become the largest home port for cruise ships in the Caribbean and the fourth largest home port for cruise ships in the world. Twenty-six U.S. and international airlines offer scheduled service to and from San Juan, and a major airline uses San Juan as a hub for its intra-Caribbean operations. This reflects the importance of Puerto Rico as a tourist destination and as a transportation hub in the Caribbean.

Recent Events

Preliminary Revenues and Expenditures for Fiscal Year 2002. For the fiscal year ended June 30, 2002, preliminary General Fund revenues (on a cash basis) were \$7.50 billion, which is \$540 million or 7.8% higher than General Fund revenues during fiscal year 2001, and \$37 million higher than originally budgeted revenues for this period. Preliminary revenues for fiscal year 2002 included \$6.90 billion of recurring revenues and \$472 million of non-recurring revenues, including the liquidation of certain reserves which were no longer required, the sale of certain receivables due from various municipalities to Government Development Bank, the collection of past due receivables from other governmental entities, and a one-time payment from a taxpayer with respect to a disallowed deduction. Preliminary revenues for fiscal year 2002 also included \$129 million of taxes already collected in prior periods but not previously applied against outstanding tax receivables.

Expenditures for the 2002 fiscal year are estimated to be \$7.64 billion, which is \$140 million or 1.9% higher than the \$7.50 billion revised budget for the fiscal year, which revised budget is based on preliminary General Fund revenues for the fiscal year. The principal reasons for the higher expenditures are (i) health costs that are estimated to be approximately \$152 million higher than the amount in the revised budget (mostly as a result of health reform costs); (ii) payroll and other costs of education that are estimated to be approximately \$77 million higher than the amount in the revised budget; and (iii) public safety costs that are estimated to be approximately \$47 million higher than the amount in the revised budget. Lower estimated expenditures in other areas of approximately \$139 million partially offset the higher health, education and public safety expenditures. The Government expects to cover these additional expenditures with \$120 million of reserve funds from the Commonwealth's Budgetary Fund and with \$20 million of unused funds from certain agencies that have operating surpluses.

Approved Budget for Fiscal Year 2003. The approved budget for fiscal year 2003 (which commenced on July 1, 2002) includes General Fund expenditures of \$7.84 billion, which is \$373 million or 5.0% higher than the \$7.47 billion originally budgeted for fiscal year 2002. The major changes in General Fund expenditures from the amount originally budgeted in fiscal year 2002 to fiscal year 2003 are the following: (i) an increase of \$122 million or 5.3% in education costs; (ii) an increase of \$119 million or 9.2% in public safety and protection costs; (iii) an increase of \$88 million or 7.4% in health costs; (iv) an increase of \$32 million or 45.8% in special pension contributions costs; (v) an increase of \$16 million or 4.1% in welfare costs; (vi) a decrease of \$14 million or 1.8% in general government expenses; and (vii) an increase of \$11 million or 3.1% in contributions to the municipalities.

General Fund revenues for fiscal year 2003 are projected to be \$7.84 billion. The major changes from the preliminary revenues of \$7.50 billion for fiscal year 2002 to projected revenues in fiscal year 2003 are expected to be: (i) a projected increase in individual income taxes of \$371 million; (ii) a projected increase in corporate income taxes of \$218 million; (iii) a projected increase in Commonwealth excise taxes of \$328 million; and (iv) a projected decrease in miscellaneous non-tax revenues of \$549 million (which is principally the result of the \$472 million of non-recurring revenues in fiscal year 2002).

For July 2002, the only month of fiscal year 2003 for which the Treasury Department has revenue information available, General Fund revenues were \$488 million, which is \$40 million or 8.9% higher than General Fund revenues during July 2001, and \$7 million or 1.4% higher than budgeted revenues for this period.

The projected General Fund revenues for fiscal year 2003 assume a 6.8% nominal, 2.7% real growth in gross national product, and additional revenues of \$596 million from recently enacted legislative measures. Projected revenues do not take into consideration the result of a lawsuit filed by one of the eight air cargo carriers that service Puerto Rico. In the lawsuit, this air cargo carrier seeks to prevent the Treasury Department from implementing a local regulation that

precludes the carrier from delivering goods brought into the island prior to the obtaining from the consignee evidence of the payment of the excise tax on such goods. The United States District Court for the District of Puerto Rico entered a permanent injunction in favor of the carrier. The Secretary of the Treasury appealed and moved for a stay pending the appeal. On July 18, 2002, the United States Court of Appeals granted the Secretary's motion and ordered the stay of the injunction while expediting the appeal. A hearing was held on September 6, 2002. The total amount of excise taxes collected annually in recent years by the eight air cargo carriers that service Puerto Rico has been approximately \$53 million.

Contracts with Health Reform Insurance Companies. The Government has entered into new contracts with the insurance companies providing coverage to health reform beneficiaries, which are for three-year terms commencing on July 1, 2002. Under the new contracts, and based on certain assumptions relating to the number of beneficiaries and other matters, the cost of the health insurance program for fiscal year 2003 is expected to exceed the amount in the budget for such fiscal year by approximately \$75 million. However, the Government expects to reduce the insurance cost through audits of the health reform lists of eligible beneficiaries and from rebates on medications from pharmaceutical companies. The budgeted amount includes all funds expected to be deposited in the newly created Health Reform Stabilization Fund, which will be funded from certain excise taxes that were recently raised. The insurance cost for fiscal years 2004 and 2005 will be negotiated with the insurance companies before the commencement of each such fiscal year.

Special Communities Perpetual Trust. On August 19, 2002, the Governor of the Commonwealth proposed and introduced legislation for the creation of a Special Communities Perpetual Trust of \$1 billion to serve primarily the housing and basic infrastructure needs of over 686 needy communities throughout the Commonwealth. The corpus of this Trust is proposed to be constituted from a \$500 million transfer from Government Development Bank and \$500 million from the Commonwealth. The proposed financing plan of the Commonwealth's contribution is under the consideration by the Commonwealth's Legislature.

Fiscal Management

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

Section 7 of Article VI of the Constitution of Puerto Rico provides that "The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

The financial statements of the Commonwealth for fiscal 2001 were audited by KPMG LLP, whose report thereon is dated January 21, 2002. KPMG LLP did not audit the financial statements of the pension trust funds, the public university funds, and certain activities and component units separately identified in their report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and their opinion on the general purpose financial statements, insofar as it relates to the amounts included in the general purpose financial statements pertaining to such activities and component units, is based solely on the reports of the other auditors. For a summary of the Commonwealth's significant accounting policies, see Note 1 to the Commonwealth's general purpose financial statements included in the Commonwealth's Annual Financial Report. Preparation of the audited financial statements of the Commonwealth involves the collection and combination of audited financial statements from 50 separate reporting entities.

Debt Management

The Constitution of Puerto Rico limits the amount of general obligation debt that can be issued. The Commonwealth's policy has been and continues to be to maintain the level of such debt within a prudent range below the constitutional limitation. See "Payment of and Security for the Notes - Debt Limitation with Respect to Full Faith and Credit Obligations" under *The Notes*.

Public Sector Debt

Public sector debt comprises bonds and notes of the Commonwealth, its municipalities, and public corporations ("notes" as used in this section refers to certain types of non-bonded debt regardless of maturity), subject to the exclusions described below. Direct debt of the Commonwealth is supported by Commonwealth taxes. Debt of municipalities, other than bond anticipation notes, is supported by real and personal property taxes and municipal license taxes. Debt of public corporations, other than bond anticipation notes, is generally supported by the revenues of such corporations from rates charged for services or products. However, certain debt of public corporations is supported, in whole or in part, directly or indirectly, by Commonwealth appropriations or taxes.

The following table presents a summary of public sector debt as of July 31, 2002. Excluded from the table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products, except as otherwise noted in footnote 4 to the table below. Also excluded from the table is debt the inclusion of which would reflect double counting, including, but not limited to, \$958,285,000 of bonds outstanding by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and \$1,277,422,000 of obligations of GDB issued to purchase certain Commonwealth public sector debt and for other purposes, of which \$267,000,000 is guaranteed by the Commonwealth.

Commonwealth of Puerto Rico
Public Sector Debt
(in thousands)

	<u>July 31, 2002</u>
Puerto Rico direct debt (1)	\$5,981,402
Municipal debt	1,719,752
Public corporations debt	
Puerto Rico guaranteed debt (2)	610,467
Debt supported by Puerto Rico appropriations or taxes (3)	13,733,813
Other non-guaranteed debt (4)	<u>6,917,954</u>
Total public corporations debt	<u>21,262,234</u>
Total public sector debt	<u>\$28,963,388</u>

-
- (1) Includes \$5,694,629,590 of general obligation bonds outstanding as of July 31, 2002. As of August 8, 2002, the total amount of general obligation bonds outstanding was \$6,148,789,590, including bonds issued on that date. Also includes \$57,630,000 of certain indebtedness originally issued by the Urban Renewal and Housing Corporation that was transferred to the Commonwealth. This amount does not include the Notes being offered hereby.
 - (2) Consists of \$475,013,000 of bonds issued by the Aqueduct and Sewer Authority and \$135,454,000 of State Revolving Fund Loans, incurred under various federal water laws. Excludes \$2,035,180,000 of Public Buildings Authority bonds and notes, which are primarily payable from Commonwealth appropriations and \$267,000,000 of GDB bonds payable from available moneys of GDB.
 - (3) Represents, among others, bonds and notes issued by the Aqueduct and Sewer Authority, the Highway and Transportation Authority, the Public Buildings Authority, the Public Finance Corporation, the Infrastructure Financing Authority and the Housing Finance Authority and notes of the Health Facilities and Services Administration which were assumed by the Department of Health.
 - (4) Includes \$1,081,550,000 of Infrastructure Financing Authority bonds which are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company, and \$397,005,000 of The Children's Trust Fund bonds which are payable solely from a portion of the payments to be received pursuant to the tobacco litigation settlement.

Source: Government Development Bank

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

Trends of Public Sector Debt

Historically, the Commonwealth has maintained a fiscal policy that provides for a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. During fiscal years 1996, 1997 and 1998, however, public sector debt increased at a greater rate than the growth of gross product due to an increase in the amount of debt incurred to finance certain key infrastructure projects that were important to the development of the economy and were expected to produce long-term economic benefits, and debt incurred to refinance outstanding debt, enabling Puerto Rico to benefit from historically low levels of interest rates and realize debt service savings. During fiscal years 1999 and 2000, the growth of public sector debt was below the growth of gross product. Public sector debt increased by 12.1% during fiscal year 2001, compared to a 6.7% increase in gross product for the same year. The increase in the rate of growth of public sector debt during fiscal year 2001 was due to the issuance during such fiscal year of \$1,092,550,000 of bonds of the Infrastructure Financing Authority and \$397,005,000 of bonds of the Children's Trust Fund, both of which are payable from sources other than Commonwealth appropriations or taxes or

revenues of public corporations derived from services or products. Excluding these bond issues, the rate of growth of public sector debt for fiscal year 2001 would have been 5.9%.

The following table shows the trends in gross product (in current dollars) and public sector debt for the five fiscal years ended June 30, 2002. Information on the growth rate of gross product during fiscal 2002 is not yet available.

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

<u>June 30</u>	<u>Public Sector Debt</u>				<u>Gross Product (2)</u>		
	<u>Long Term</u>	<u>Short Term (3)</u>	<u>Short Term as % of Total</u>	<u>Total (1)</u>	<u>Rate of Increase</u>	<u>Amount</u>	<u>Rate of Increase</u>
1998	20,759	1,563 ⁽⁴⁾	7.0	22,322	14.4	35,111	8.6
1999	20,905	1,772 ⁽⁴⁾	7.8	22,677	1.6	38,281	9.0
2000	21,620	2,202 ⁽⁴⁾	9.2	23,822	5.0	41,442	8.3
2001	23,833	2,871 ⁽⁵⁾	10.8	26,704	12.1	44,211	6.7
2002	28,208	1,250 ⁽⁴⁾	4.2	29,458	10.3	N/A	N/A

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

(2) In current dollars.

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

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

(5) Includes a \$164 million line of credit from Government Development Bank to the Secretary of the Treasury whose proceeds were applied to pay debt service on general obligation bonds in lieu of funds available therefor in the General Fund.

Source: Government Development Bank

THE NOTES

General

The Notes are dated their date of delivery, mature on July 30, 2003 and bear interest at the rate set forth on the cover of this Official Statement. Interest is computed on the basis of twelve 30-day months and a 360-day year. The Notes are issuable in fully registered form in denominations of \$5,000 and any integral multiple thereof. The Notes are not subject to redemption prior to maturity. Principal of and interest on the Notes are payable in immediately available funds at maturity.

Book-Entry Only System

The following information concerning The Depository Trust Company (“DTC”), New York, New York, and DTC’s book-entry system has been obtained from DTC. Neither the Commonwealth nor the Underwriters take any responsibility for the accuracy thereof.

DTC will act as securities depository for the Notes. The Notes will be issued as fully-registered Notes 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 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, Inc. and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (the "Indirect Participants"). The rules applicable to DTC and its Direct and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of the Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Notes on DTC's records. The ownership interest of each actual purchaser of a Note (a "Beneficial Owner") is in turn recorded on the Direct and 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 Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of the Beneficial Owners. Beneficial Owners will not receive definitive Notes, except in the event that use of the book-entry system for the Notes is discontinued.

To facilitate subsequent transfers, all Notes 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 Notes with DTC and their registration in the name of Cede & Co. or such other nominee effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Direct and Indirect 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. (or such other DTC nominee) will consent or vote with respect to the Notes. Under its usual procedures, DTC mails an Omnibus Proxy to the Commonwealth as soon as possible after the applicable record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Notes will be made to DTC or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Commonwealth, on the payable date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payable date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, Government Development Bank, as paying agent (the "Paying Agent"), or the Commonwealth, subject to any statutory or regulatory requirements as may be in effect from time

to time. Payment of principal and interest to DTC or such other nominee as may be requested by an authorized representative of DTC is the responsibility of the Commonwealth or the Paying Agent, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

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

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

In the event that such book-entry only system is discontinued, the following provisions will apply: principal of and interest on the Notes will be payable at maturity in lawful money of the United States of America upon presentation and surrender of Notes at the principal office of the Paying Agent, in San Juan, Puerto Rico. The Notes will be issued only as registered Notes without coupons in denominations of \$5,000 or any integral multiple thereof. The transfer of the Notes will be registrable and they may be exchanged at the principal office of the Paying Agent in San Juan, Puerto Rico, upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Authorization of Notes

Section 2 of Article VI of the Constitution of the Commonwealth provides that the power of the Commonwealth to contract and to authorize the contracting of debts shall be exercised as determined by the Legislature. Pursuant to this power, the Legislature enacted the Act which authorizes the issuance of the Notes.

Purpose of the Notes

The Notes are being issued to (i) fund a portion of the Commonwealth's projected cash requirements for fiscal 2003, which requirements result from timing differences between expected disbursements and receipts of taxes and revenues and (ii) pay certain costs of issuance of the Notes.

Payment of and Security for the Notes

Provision for Payment of the Notes

The Notes are direct obligations of the Commonwealth. The Notes are payable solely from the taxes and revenues in the General Fund collected by the Secretary of the Treasury after the date of issuance of the Notes and on or prior to June 30, 2003 and deposited in the Note Fund. After any required transfers from the General Fund to the Special Fund for the Amortization of General Obligations Evidenced by Bonds and Promissory Notes (the "Redemption Fund"), the Secretary of the Treasury, beginning April 1, 2003, will withdraw from the General Fund all taxes and revenues required to be deposited therein from April 1, 2003 until June 30, 2003, together with any taxes and revenues collected after the issuance of the Notes and then on deposit in the General Fund. Such taxes and revenues will be deposited in the Note Fund until the amount on deposit in the Note Fund in the months indicated below equals the following percentages of the sum of the principal of and interest on the Notes due at maturity (such sum being herein called the "Note Fund Requirement"):

<u>2003</u>	<u>Percentage of Note Fund Requirement</u>
April	33 $\frac{1}{3}$ %
May	66 $\frac{2}{3}$ %
June	100%

The Secretary of the Treasury covenants in the Note Resolution to compute on a cash basis on or before the tenth day of each month, commencing October 10, 2002, projected taxes and revenues expected to be deposited in, expenditures from, and fund balances of the General Fund for each month remaining in fiscal 2003. If, on the basis of such computations, the Secretary of the Treasury determines that the Note Fund Requirement less any amount then on deposit in the Note Fund equals or exceeds 85% of the sum of all taxes and revenues expected to be deposited in the General Fund from the later of the date of such determination and April 1, 2003 through June 30, 2003 after accounting for any required transfers from the General Fund to the Redemption Fund, the Secretary of the Treasury shall immediately withdraw sufficient amounts of taxes and revenues as received from the General Fund, shall make any required transfers to the Redemption Fund, and thereafter shall transfer to the Note Fund sufficient amounts of such taxes and revenues as received as will cause the amount on deposit in the Note Fund to equal the Note Fund Requirement.

All moneys in the Note Fund shall be used to pay principal of and interest on the Notes at maturity and shall be used for no other purpose; provided, however, that pursuant to certain constitutional and statutory authorizations, payments on general obligation bonds and notes of the Commonwealth and on bonds and notes of its public corporations guaranteed by the Commonwealth have a claim on Commonwealth taxes and revenues, including amounts on deposit in the Note Fund, prior to the claim thereon of the Notes.

Neither the full faith, credit and taxing power of the Commonwealth nor that of any of its political subdivisions are pledged for the payment of principal of or interest on the Notes.

Provision for Prior Payment of Full Faith and Credit Obligations of the Commonwealth

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

Under the provisions of Act No. 39 of the Legislature of Puerto Rico, approved May 13, 1976, as amended, the Secretary of the Treasury is obligated to fund annual debt service on general obligation bonds and notes of the Commonwealth by monthly deposits into the Redemption Fund. As of June 30, 2002, the amount on deposit in the Redemption Fund was \$237 million which was the required amount. Fiscal 2003 deposits from the General Fund to the Redemption Fund to fund the projected debt service through July 1, 2003, exclusive of debt service on any general obligation bonds that may be issued in fiscal 2003, are expected to total \$376 million.

Moneys in the Redemption Fund are not available to pay the Notes.

Debt Limitation with Respect to Full Faith and Credit Obligations

Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes theretofore issued which is payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenues raised under the provisions of Commonwealth legislation and covered into the Treasury of Puerto Rico (hereinafter "internal revenues") in the two fiscal years preceding the then current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as its payments during the preceding fiscal year in respect of any such guaranteed debt do not cause the 15% limitation to be exceeded. Certain revenues, such as federal excise taxes on offshore shipments of cased rum and tobacco products and customs duties, which are collected by the United States Government and returned to the Treasury of Puerto Rico, and motor vehicle fuel taxes and license fees, which are allocated to the Highway and Transportation Authority, are not included as internal revenues for the purpose of calculating the debt limit, although they may be available for the payment of debt service.

As of the date of this Official Statement, the amount of principal of and interest on outstanding full faith and credit bonds and notes of the Commonwealth payable in any fiscal year, together with amounts paid by the Commonwealth during fiscal 2002 on account of bonds and notes guaranteed by the Commonwealth, equals 9.64% of the Commonwealth's average annual internal revenues during fiscal years 2001 and 2002. After giving effect to the issuance of certain forward delivery bonds that have been sold but not yet delivered, such percentage would be 9.65%. If certain bonds issued by the Commonwealth that have been refunded were treated as not being outstanding (they will be treated as outstanding because they were refunded with proceeds invested in guaranteed investment contracts and non-eligible securities), and after giving effect to the issuance of the forward delivery bonds previously described, such percentage would be 7.86%.

The Notes are not subject to the above described constitutional debt limitation.

Estimated Note Revenues

The Commonwealth estimates that the taxes and revenues available for deposit in the Note Fund for fiscal 2003 (consisting of taxes and revenues projected to be collected after the issuance of the Notes and prior to June 30, 2003, minus required deposits to the Redemption Fund) will be approximately \$6.2 billion. For fiscal 2002, taxes and revenues which would have been available for deposit in the Note Fund were approximately \$5.7 billion.

Debt Limitation with Respect to Additional Parity Notes

The aggregate principal amount of notes issued under the Act with respect to any fiscal year and outstanding at any time shall not exceed \$800,000,000. The Act provides that any notes issued thereunder shall mature on such date or dates not exceeding 30 days after the close of the fiscal year in which such notes are issued. The Commonwealth previously has issued notes under the Act, which notes have since matured and been paid in full. No notes of the Commonwealth are currently outstanding under the Act.

Under the Note Resolution, the Secretary of the Treasury covenants not to issue additional obligations payable on a parity with the Notes except for additional notes issued under the Act. Any additional notes issued under the Act during fiscal 2003 may not mature prior to July 30, 2003 pursuant to the Note Resolution. Unless said Notes are retired before June 30, 2003 (an eventuality not currently contemplated by the Commonwealth), the Act will preclude the issuance of additional notes because the principal amount of the Notes offered hereby is \$800,000,000.

Payment Record

The Commonwealth has never defaulted on the payment of principal of or interest on any of its debt.

PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES

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

The General Fund is the primary operating fund of the Commonwealth. General Fund revenues are broadly based and include revenues raised internally as well as those from non-Commonwealth sources. Internal revenues consist principally of income taxes and excise taxes. Revenues from non-Commonwealth sources are derived from federal excise

taxes and customs duties returned to the Commonwealth. The primary expenditures of the Commonwealth through the General Fund are for grants and subsidies and personal and other services.

Summary and Management Discussion of General Fund Results

The following table presents the Commonwealth revenues and expenditures of the General Fund on a cash basis for fiscal 1999 through fiscal 2002 and the Commonwealth's estimated revenues and expenditures for fiscal 2003. The information through fiscal 2001 is based on actual fiscal year-end results. The information relating to fiscal 2002 is preliminary and subject to audit adjustments. The amounts shown on the table as expenditures are different than those that appear in the budget because the table shows only cash disbursements, while the budget includes all authorized expenditures, regardless of when the related cash is actually disbursed. In addition, transfers to the Redemption Fund, which are included in the budget, are shown separately on the table and are not included as expenditures. Finally, in fiscal year 2002 there were approximately \$140 million of expenditures that were not originally budgeted but were incurred, and that are not reflected in the table as expenditures, most of which are expected to be covered from moneys in the Budgetary Fund.

To improve the presentation of the following table, the Department of the Treasury has eliminated the use of line items identified as "Operating Transfers In" and "Operating Transfers Out" in the financial statements of the Commonwealth and has assigned the amounts previously listed under these two categories to the following revenue and expenditure line items according to the purpose and amount of each transfer: "Other Income," "Other Expenditures," "Capital Outlays and Other Debt Service" and "Transfers to Agencies." Amounts listed under "Other Income" represent recurring General Fund revenues not appropriately attributable to other revenue line items such as repayment of General Fund advances to municipalities and government agencies and funds. "Other Expenditures" represent recurring General Fund expenditures not appropriately attributable to other expenditures line items such as advances to government agencies and municipalities which advances are to be reimbursed to the General Fund by law. Amounts listed under "Capital Outlays and Other Debt Service" represent debt service on obligations and capital expenditures for which the Legislature has by resolution agreed to appropriate funds. "Transfers to Agencies" represent moneys appropriated for the operation of the Health Facilities and Services Administration. General Fund revenues, expenditures and transfers as presented in the table differ from the General Fund revenues, expenditures and transfers as presented in the financial statements of the Commonwealth, as the latter statements reflect an expanded General Fund entity in accordance with generally accepted accounting principles.

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

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002(P)</u>	<u>Estimated 2003(1)</u>
Beginning cash balance	\$ 340,771	\$ 474,759	\$ 287,055	\$ 125,154	\$235,772
Revenues from internal sources:					
Income Taxes:					
Individuals	2,244,376	2,352,066	2,259,090	2,404,482	2,775,000
Corporations	1,653,762	1,781,862	1,696,766	1,627,719	1,846,000
Partnerships	2,087	2,339	3,026	2,670	3,000
Withheld from non-residents	369,384	557,276	696,835	583,256	560,000
Tollgate taxes	114,533	111,130	49,511	59,515	36,000
Interest	10,666	11,674	14,782	14,310	16,000
Dividends	38,996	39,664	58,580	62,548	43,000
Total income taxes	<u>4,433,804</u>	<u>4,856,011</u>	<u>4,778,590</u>	<u>4,754,500</u>	<u>5,279,000</u>
Commonwealth excise taxes:					
Alcoholic beverages	243,464	236,374	237,512	249,705	326,000
Cigarettes	119,105	115,157	119,135	116,055	170,000
Motor vehicles	411,573	389,995	406,252	418,024	505,000
Other excise taxes	699,685	668,820	579,050	634,762	746,000
Total Commonwealth excise taxes	<u>1,473,827</u>	<u>1,410,346</u>	<u>1,341,949</u>	<u>1,418,546</u>	<u>1,747,000</u>
Property taxes	2,214	1,131	287	-	-
Inheritance and gift taxes	1,811	3,109	7,475	1,962	2,000
Licenses	70,848	73,801	76,338	82,575	84,000
Other:					
Lottery	59,206	63,779	57,482	61,358	70,000
Electronic Lottery	53,013	70,209	70,211	57,897	87,000
Miscellaneous	176,669	169,246	299,758	780,713	232,000
Total other	<u>288,888</u>	<u>303,234</u>	<u>427,451</u>	<u>899,968</u>	<u>389,000</u>
Total revenues from internal sources	<u>6,271,392</u>	<u>6,647,632</u>	<u>6,632,090</u>	<u>7,157,551</u>	<u>7,501,000</u>
Revenues from non-Commonwealth sources:					
Federal excise taxes	217,296	245,750	286,890	314,253	305,000
Customs	61,355	50,231	43,154	30,595	30,000
Total revenues from non-Commonwealth sources	<u>278,651</u>	<u>295,981</u>	<u>330,044</u>	<u>344,848</u>	<u>335,000</u>
Total Revenues	<u>6,550,043</u>	<u>6,943,613</u>	<u>6,962,134</u>	<u>7,502,399</u>	<u>7,836,000</u>
Other income (refunds) (2)	2,570	64,325	84,878	53,796	(89,000)
Transfers to Redemption Fund (3)	(320,240)	(410,046)	(245,814)	(274,773)	(375,889)
Proceeds of notes and other borrowings (4)	600,000	778,863	825,703	1,161,856	1,509,444
Repayment of notes and other borrowings (5)	(611,410)	(787,155)	(686,024)	(1,201,084)	(1,521,500)
Adjusted revenues	<u>6,220,963</u>	<u>6,589,600</u>	<u>6,940,877</u>	<u>7,242,194</u>	<u>7,359,055</u>
Expenditures:					
Grants and subsidies	2,392,018	2,864,215	3,078,505	2,864,533	3,006,961
Personal services	2,470,456	2,737,159	2,779,989	3,017,984	3,600,509
Other services	723,563	745,194	778,236	757,090	736,444
Materials and supplies	99,404	109,081	106,072	105,532	155,828
Equipment purchases	52,993	56,404	46,326	20,354	31,196
Capital outlays and other debt service	166,841	101,178	33,235	51,172	-
Transfers to agencies	181,700	164,073	280,415	314,911	-
Total expenditures	<u>6,086,975</u>	<u>6,777,304</u>	<u>7,102,778</u>	<u>7,131,576</u>	<u>7,530,938</u>
Adjusted revenues less expenditures	<u>133,988</u>	<u>(187,704)</u>	<u>(161,901)</u>	<u>110,618</u>	<u>(171,883)</u>
Ending cash balance	<u>\$ 474,759</u>	<u>\$ 287,055</u>	<u>\$ 125,154</u>	<u>\$ 235,772</u>	<u>\$ 63,890</u>

(P) Preliminary.

(1) Revenues as per budget. Expenditures are shown on a cash basis.

(2) Consists of net revenue from General Fund's non budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.

(3) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.

(4) Consists of proceeds of borrowing from Government Development Bank and proceeds from Commonwealth's Tax and Revenue Anticipation Notes.

(5) Consists of repayment of borrowing from Government Development Bank and repayment of Commonwealth's Tax and Revenue Anticipation Notes.

Source: Department of Treasury

Projected Fiscal Year 2003 Compared to Preliminary Fiscal Year 2002

It is projected that General Fund total revenues for fiscal year 2003 (excluding proceeds from special funds) will be \$7.84 billion, representing an increase of \$334 million, or 4.5%, from preliminary fiscal year 2002 revenues (on a cash basis) of \$7.50 billion. (The budget for the fiscal year also includes \$3 million of transfers from certain unused reserves.) The major changes from fiscal year 2002 are expected to be: (i) projected increases in income taxes from individuals of \$371 million and in corporate income taxes of \$218 million; (ii) a projected increase in Commonwealth excise taxes of \$328 million; and (iii) a projected decrease in miscellaneous non-tax revenues of \$549 million (which is principally the result of the \$472 million of non-recurring revenues in fiscal year 2002).

For July 2002, the only month of fiscal year 2003 for which the Treasury Department has revenue information available, General Fund revenues were \$488 million, which is \$40 million or 8.9% higher than General Fund revenues during July 2001, and \$7 million or 1.4% higher than budgeted revenues for this period.

The projected General Fund revenues for fiscal year 2003 assume a 6.8% nominal, 2.7% real growth in gross national product, and additional revenues of \$596 million from recently enacted legislative measures. Projected revenues do not take into consideration the result of a lawsuit filed by one of the eight air cargo carriers that service Puerto Rico, in which the air cargo carrier seeks to prevent the Treasury Department from implementing a local regulation that precludes the carrier from delivering goods brought into the island prior to the consignee evidencing the payment of the excise tax on such goods. The total amount of excise taxes collected annually in recent years by the eight air cargo carriers that service Puerto Rico has been approximately \$53 million. (See “Recent Events - Approved Budget for Fiscal Year 2003” under *Overview*.)

The projected ending cash balance for the General Fund for fiscal 2003 is \$64 million, a decrease of \$172 million from fiscal 2002.

Preliminary Fiscal Year 2002 Compared to Actual Fiscal Year 2001

For the fiscal year ended June 30, 2002, General Fund preliminary revenues (on a cash basis) were \$7.50 billion, which is \$540 million or 7.8% higher than General Fund revenues during fiscal year 2001. Preliminary revenues for fiscal year 2002 included \$6.90 billion of recurring revenue and \$472 million of non-recurring revenues, including the liquidation of certain reserves which were no longer required, the sale of certain receivables due from various municipalities to Government Development Bank, the collection of past due receivables from other governmental entities, and a one-time payment from a taxpayer with respect to a disallowed deduction. Preliminary revenues for fiscal year 2002 also included \$129 million of taxes already collected in prior periods but not previously applied against outstanding tax receivables. The major changes from fiscal year 2001 were: (i) an increase in income taxes from individuals of \$145 million, a decrease in corporate income taxes of \$69 million, and a decrease in income taxes withheld from non-residents of \$114 million; (ii) an increase in Commonwealth excise taxes of \$77 million; and (iii) an increase in miscellaneous non-tax revenues of \$481 million, which includes the non-recurring revenues described above. The increase in income taxes collected from individuals was due principally to tougher enforcement. The decrease in collected corporate income taxes was due principally to the continued economic slowdown in the United States and Puerto Rico.

Preliminary cash expenditures during the 2002 fiscal year were \$7.13 billion, which is \$29 million or 0.4% higher than cash expenditures during fiscal year 2001. In addition, transfers to the Redemption Fund were \$275 million. (However, revised budgeted expenditures for fiscal year 2002 were \$7.50 billion, and actual expenditures for such fiscal year are estimated to be \$7.64 billion. See “Recent Events - Preliminary Revenues and Expenditures for Fiscal Year 2002” under *Overview* above.)

The preliminary ending cash balance for the General Fund for fiscal 2002 was \$236 million, an increase of \$111 million from fiscal year 2001. This increase resulted principally from timing differences in the payment of authorized expenditures.

Fiscal Year 2001 Compared to Fiscal Year 2000

General Fund total revenues for fiscal year 2001 were \$6.96 billion, an increase of approximately \$19 million from fiscal year 2000. The major changes from fiscal year 2000 were: a decrease of \$85 million in corporate income taxes; a decrease of \$93 million in individual income taxes; a decrease of \$62 million in tollgate taxes; a decrease of \$90 million in other excise taxes; an increase in income tax withheld from non-residents of \$140 million; and an increase in federal excise taxes of \$41 million. The decrease in corporate income taxes was due to the effects of the economic slowdown in the United States and Puerto Rico. The reduction in tollgate taxes and the increase in withholding taxes to non-residents were the result of continuing conversions of corporations to controlled foreign corporation tax status and the payment of withholding taxes on royalties paid to U.S. affiliates. The reduction in local excise taxes allocated to the General Fund was attributable principally to a reduction in the tax on crude oil (which varies inversely with the price of crude oil) and a transfer of certain excise taxes from the General Fund to other funds of the Commonwealth as required by Commonwealth legislation. Federal excise tax revenues rose due to growing exports of rum products. Commencing in fiscal year 2000 the amount of the rum excise tax returned to the Treasury of Puerto Rico increased from \$10.50 to \$13.25 per gallon. See “Major Sources of General Fund Revenues” under *Puerto Rico Taxes, Other Revenues and Expenditures*.

Total expenditures for fiscal year 2001 were \$7.10 billion, an increase of \$325 million, or 4.8%, over fiscal year 2000. Expenditures grew primarily in the areas of education, health and public safety. This growth is attributable in part to the rising cost of services and expanding programs. In addition, transfers to the Redemption Fund totaled \$246 million. The ending cash balance for the General Fund for fiscal year 2001 was \$125 million, a decrease of \$162 million from fiscal year 2000. This decrease, together with moneys raised by the Commonwealth from short-term borrowings that were not repaid in full prior to the end of fiscal year 2001, enabled the Commonwealth to cover expenses in said year in excess of the amount budgeted therefor and in the face of a decline in General Fund revenues. General Fund deposits to the Redemption Fund in fiscal year 2001 were \$113 million less than in fiscal year 2000 because the last four monthly deposits in fiscal year 2001 were made from the proceeds of a short-term loan from GDB, which loan was repaid in early fiscal year 2002 from the proceeds of general obligation bonds issued in June 2001.

In lieu of issuing tax and revenue anticipation notes in fiscal year 2001 to meet seasonal differences in the timing of revenues and expenses, the Commonwealth obtained a loan from the GDB in the amount of \$661 million. This loan has been repaid.

Fiscal Year 2000 Compared to Fiscal Year 1999

General Fund total revenues for fiscal year 2000 were \$6.94 billion, an increase of \$394 million, or 6.0%, over fiscal year 1999. The major changes were: an increase in revenues obtained from income taxes of \$422 million and a decrease in Commonwealth excise taxes of \$63 million.

Total expenditures for fiscal year 2000 were \$6.78 billion, an increase of \$690 million, or 11.3%, over fiscal year 1999. The ending cash balance for the General Fund for fiscal year 2000 was \$287 million, a decrease of \$188 million from fiscal year 1999.

Major Sources of General Fund Revenues

Income Taxes

The Commonwealth’s income tax law, the Internal Revenue Code of 1994, as amended (the “PR Code”), imposes a tax on the income of individual residents of Puerto Rico, trusts, estates, and domestic and foreign (if engaged in a trade or business in Puerto Rico) corporations and partnerships. A withholding tax is imposed on certain payments made to non-residents of Puerto Rico.

Individuals. Resident individuals are subject to tax on their taxable income from all sources. Prior to January 1, 2000, the PR Code had five tax brackets for individuals with tax rates of 8%, 12%, 18%, 31% and 33%. As a result of

legislation enacted in 1999, the first four brackets were reduced to 7.5%, 11%, 16.5% and 29.5% for the taxable year commencing on January 1, 2000, to 7%, 10%, 15% and 28% for taxable year commencing on January 1, 2001, and 6%, 9%, 14% and 27% for the taxable years commencing on and after January 1, 2004. Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at a rate of 10%. A recent amendment to the PR Code provides an income tax credit for individuals whose adjusted gross income is equal to or less than \$10,000. This tax credit may be taken against any income tax payable and is only applicable to income generated from wages.

Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a rate of 20% or 10% if the capital asset consists of certain property located in Puerto Rico sold or exchanged after December 31, 2000. Gains realized by Puerto Rico resident individuals, trusts and estates from the sale of stock of certain Puerto Rico corporations in an initial public offering made prior to January 1, 2008 are subject to a special capital gains rate of 7%.

Interest income in excess of \$2,000 on deposits with Puerto Rico financial institutions is taxed at a rate of 17%, provided the taxpayer elects that the financial institution withhold said 17% at source; the first \$2,000 of interest income from such institutions is exempt from taxation. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident individuals, trusts and estates qualifies for a special 17% tax rate, provided the taxpayer elects to have the 17% tax withheld at source.

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

The PR Code provides for six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to taxable income in excess of \$275,000. Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a maximum rate of 25% or 12.5% if the capital asset consists of certain property located in Puerto Rico sold or exchanged after December 31, 2000. The PR Code also provides for an alternative minimum tax of 22%.

Certain corporations and partnerships covered by the tax incentives acts continue to be subject to a maximum tax rate of 45% on the taxable portion of their income, which is generally 10% of their net income, for an effective tax rate of 4.5%. Corporations and partnerships covered by the Puerto Rico Tourism Incentives Act of 1993, as amended, are subject to a maximum tax rate of 42% on the taxable portion of their income, which is also generally 10% of their net income, for an effective tax rate of 4.2%. Corporations and partnerships operating under a new grant of tax exemption issued under the 1998 Tax Incentives Act are subject to a maximum flat one-time income tax rate of 7%.

The PR Code imposes a branch profits tax on resident foreign corporations less than 80% of whose gross income qualifies as income effectively connected with a Puerto Rico trade or business. The branch profits tax is 10% of an annual dividend equivalent amount, and it applies without regard to the Puerto Rico source of income rules.

Interest from Puerto Rico sources paid to non-resident non-affiliated corporate recipients is not subject to any income or withholding tax. Interest paid to certain related non-resident recipients continues to be subject to a withholding tax of 29%. Dividends paid to non-resident corporate recipients are subject to a withholding tax of 10%. Dividends distributed by corporations (including Section 936 Corporations) operating under new grants of tax exemption issued under the 1998 Tax Incentives Act are not subject to Puerto Rico income tax. However, royalty payments made by such corporations to non-resident recipients are subject to a 10% withholding tax. The basic tax on dividends paid to foreign corporate shareholders of Section 936 Corporations operating under grants of tax exemption issued under prior incentives laws is 10% but is subject to reduction with respect to dividends paid from profits invested in Puerto Rico in certain eligible instruments for specified periods of time.

Payments in excess of \$1,500 during a calendar year made by the Commonwealth and persons engaged in a trade

or business in Puerto Rico in consideration of the receipt of services rendered in Puerto Rico are subject to a 7% withholding tax, which may be fully or partially waived in the case of corporations and partnerships.

Excise Taxes

The PR Code imposes a tax on articles and commodities that are imported into or manufactured in Puerto Rico for consumption in Puerto Rico and a tax on certain transactions, such as hotel occupancy, public shows, and horse racing. The excise tax on certain articles and commodities, such as cigarettes and petroleum products, is based upon the quantity of goods imported. The excise tax on motor vehicles is based on its suggested retail price. The PR Code imposes a tax at an effective rate of 6.6% of the F.O.B. factory price for imported goods and 3.6% of the sales price of goods manufactured in Puerto Rico, except sugar, cement, cigarettes, motor vehicles and certain petroleum products, which are taxed at different rates. Goods to be used by the government, except for motor vehicles and construction equipment, are not exempt. The excise taxes on cigarettes, sport utility vehicles and alcoholic beverages were increased effective May 16, May 30, and June 14, 2002, respectively.

Other Taxes and Revenues

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

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

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

The excise tax on shipments of cased rum from Puerto Rico and other rum-producing countries to the United States is \$13.50 per gallon. Of this amount \$13.25 per gallon was and will be returned to the Treasury of Puerto Rico from July 1, 1999 to December 31, 2003. Effective on January 1, 2004, the amount returned will be \$10.50 per gallon.

Collections of Income and Excise Taxes

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

Transfers to General Obligation Redemption Fund

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

Components of General Fund Expenditures

Grants and Subsidies

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

Personal Services

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

Other Services

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

Materials and Supplies

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

Equipment Purchases

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

Capital Outlays and Other Debt Service

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

Transfers to Agencies

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

Other Expenditures

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

Inter-Fund Borrowings

The Commonwealth historically has used inter-fund borrowings to meet temporary imbalances of receipts and disbursements in the General Fund. Act No. 147 of the Legislature of Puerto Rico, approved June 18, 1980, provides that in any fiscal year where revenues of the General Fund are not sufficient to meet approved appropriations for such year, the Governor may authorize the Secretary of the Treasury to borrow funds from Government Development Bank and, if necessary, from any funds of the Commonwealth under his custody, on such terms and conditions as the Secretary of the Treasury deems advisable. Funds available for this purpose do not include public pension funds and funds of public employees' associations. Moneys so borrowed must be repaid as soon as there is sufficient money in the General

Fund to do so. Moneys borrowed and repaid by the General Fund are accounted for as “Operating Transfers In” and “Operating Transfers Out,” respectively, on the financial statements of the Commonwealth and included in certain revenue and expenditure line items in the table entitled “General Fund Revenues, Expenditures, and Changes in Cash Balance” in “Summary and Management Discussion of General Fund Results” under *Puerto Rico Taxes, Other Revenues and Expenditures*. As of June 30, 2002, funds aggregating approximately \$597 million under the custody of the Secretary of the Treasury were available for inter-fund borrowings, if necessary. In addition, the Commonwealth has available an \$800 million line of credit with Government Development Bank, which may be used to pay the Notes, if necessary. Although this line of credit may be drawn upon by the Secretary of the Treasury for purposes other than payment of the Notes, the line of credit has in recent years been available in its entirety by April, the month when the first deposit to the Note Fund is scheduled to be made.

General Fund Monthly Cash Flow for Fiscal 2002 and Fiscal 2003

The tables which follow set forth the actual monthly cash flow for the General Fund for fiscal 2002 and the estimated monthly cash flow for fiscal 2003. The monthly cash flow for fiscal 2002 is preliminary and does not take into account any audit adjustments.

The monthly cash flow estimates for fiscal 2003 are based upon the General Fund budget for fiscal 2003 and upon historical experience as adjusted to reflect economic conditions, statutory and administrative changes and anticipated payment dates for grants and subsidies, personal and other services, materials and supplies, equipment, capital outlays, debt service and transfers. These estimates are based on present circumstances and currently available information and are believed to be reasonable. Such estimates may be affected by numerous factors, including the continuing validity of the assumptions underlying the estimates, and there can be no assurance that such estimates will be achieved.

Commonwealth of Puerto Rico
Preliminary General Fund Cash Flows
Fiscal Year 2001-2002
(in thousands)

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Beginning cash balance	\$ 125,154	\$ (351,539)	\$ (451,507)	\$ (642,899)	\$ (226,699)	\$ (480,820)	\$ (60,327)	\$ (148,286)	\$ (334,252)	\$ (292,124)	\$ (106,181)	\$ (232,561)	\$ 125,154
Receipts:													
Income taxes	252,477	370,670	354,059	350,591	286,050	405,045	398,241	205,422	367,783	870,866	311,252	582,044	4,754,500
Commonwealth excise taxes	102,550	111,277	98,351	107,579	118,623	115,678	113,225	99,129	115,430	129,332	130,931	176,441	1,418,546
Inheritance and gift taxes	368	109	10	294	108	60	157	164	119	159	227	187	1,962
Licenses	4,333	5,446	9,193	19,832	6,893	6,682	7,059	5,548	927	6,125	4,939	5,598	82,575
Other internal sources	49,051	23,085	48,982	27,073	32,754	84,010	38,362	71,060	35,602	25,438	126,795	337,756	899,968
Non-Commonwealth sources	39,083	26,182	26,868	27,357	25,090	33,267	25,544	26,079	27,504	29,198	28,963	29,713	344,848
Sub-Total receipts	447,862	536,769	537,463	532,726	469,518	644,742	582,588	407,402	547,365	1,061,118	603,107	1,131,739	7,502,399
Other income (refunds) (1)	4,358	7,138	10,209	22,154	13,248	26,037	32,807	21,251	1,670	(78,337)	1,959	(8,699)	53,796
Transfers to Redemption Fund (2)	(35,970)	(35,970)	(35,970)	(35,970)	(21,345)	(21,345)	(21,345)	(21,345)	(21,345)	0	0	(24,172)	(274,773)
Proceeds of Notes and other borrowings (3)	-	-	-	804,007	-	268,000	-	-	-	-	-	89,849	1,161,856
Repayment of Notes and other borrowing (4)	(164,200)	-	-	(217,996)	-	-	-	-	-	(272,956)	(272,956)	(272,956)	(1,201,084)
Total available cash from operations	252,030	507,938	511,702	1,104,921	461,421	917,434	594,051	407,309	527,691	709,826	332,111	915,761	7,242,194
Disbursements:													
Grants and subsidies	426,950	296,715	279,437	386,617	413,602	133,085	360,924	169,973	166,259	220,796	182,215	142,871	3,179,444
Personal services	264,529	246,278	247,986	252,088	232,826	319,538	263,210	242,410	260,604	261,257	221,399	205,859	3,017,984
Other services	30,405	54,224	166,448	37,054	26,511	31,627	49,503	172,007	47,944	33,655	43,956	63,756	757,090
Materials and supplies	6,805	8,040	7,188	10,131	14,904	10,690	7,364	7,239	9,505	6,649	10,108	6,909	105,532
Equipment purchases	-	2,465	2,021	2,719	1,559	1,935	1,008	1,646	1,251	1,525	813	3,412	20,354
Other debt service and capital outlays	34	184	14	112	26,141	66	-	-	-	-	-	24,621	51,172
Total disbursements	728,723	607,906	703,094	688,721	715,543	496,941	682,009	593,275	485,563	523,882	458,491	447,428	7,131,576
Total available cash less transfers and disbursements	(476,693)	(99,968)	(191,392)	416,200	(254,122)	420,493	(87,958)	(185,966)	42,128	185,944	(126,380)	468,333	110,618
Ending Cash Balance	\$ (351,539)	\$ (451,507)	\$ (642,899)	\$ (226,699)	\$ (480,820)	\$ (60,327)	\$ (148,286)	\$ (334,252)	\$ (292,124)	\$ (106,181)	\$ (232,561)	\$ 235,772	\$ 235,772
Ending cash balance without considering TRANS	\$ (351,539)	\$ (451,507)	\$ (642,899)	\$ (1,030,706)	\$ (1,284,827)	\$ (864,334)	\$ (952,293)	\$ (1,138,259)	\$ (1,096,131)	\$ (637,232)	\$ (490,656)	\$ 250,633	

- (1) Consists of net revenue from General Fund's non budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
- (2) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
- (3) Consists of proceeds of borrowings from Government Development Bank and proceeds from Commonwealth's Tax and Revenue Anticipation Notes.
- (4) Consists of repayment of borrowings from Government Development Bank and repayment of Commonwealth's Tax and Revenue Anticipation Notes.

Source: Department of Treasury

Commonwealth of Puerto Rico
Estimated General Fund Cash flows
Fiscal Year 2002-2003
(in thousands)

	July	August	September	October	November	December	January	February	March	April	May	June	Total (1)
Beginning cash balance	\$ 235,772	\$ (292,474)	\$ (358,834)	\$(459,790)	\$ (63,852)	\$ (200,671)	\$ (82,248)	\$ (53,671)	\$ (175,491)	\$ (52,823)	\$ 284,689	\$ (26,642)	\$ 235,772
Receipts:													
Income taxes	299,500	303,900	422,700	342,000	276,900	458,300	413,000	259,400	437,700	1,042,100	337,000	686,500	5,279,000
Commonwealth excise taxes	127,500	151,500	122,000	138,500	151,900	157,800	148,800	127,500	148,900	154,400	149,900	168,300	1,747,000
Inheritance and gift taxes	100	100	100	100	200	200	200	200	200	200	200	200	2,000
Licenses	4,700	5,300	7,700	22,200	6,800	6,100	6,000	5,000	4,900	5,100	5,100	5,100	84,000
Other internal sources	22,900	22,400	39,600	34,200	21,100	57,100	22,500	21,400	44,100	27,800	29,800	46,100	389,000
Non-Commonwealth sources	26,500	26,900	27,300	27,700	29,200	35,900	27,100	26,500	26,100	26,200	27,400	28,200	335,000
Sub-Total receipts	481,200	510,100	619,400	564,700	486,100	715,400	617,600	440,000	661,900	1,255,800	549,400	934,400	7,836,000
Other income (refunds) (2)	(72,342)	10,342	30,000	30,000	26,541	27,891	28,058	16,092	(8,360)	(119,801)	(13,676)	(43,746)	(89,000)
Transfers (Refunding to Redemption Fund) (3)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(31,324)	(375,889)
Proceeds of notes and other borrowings (4)	200,000	255,000	250,000	804,444	-	-	-	-	-	-	-	-	1,509,444
Repayments of notes and other borrowing (5)	(125,000)	(45,000)	(255,000)	(280,000)	-	-	-	-	-	(272,167)	(272,167)	(272,166)	(1,521,500)
Total available cash from operations	452,534	699,118	613,076	1,087,820	481,317	711,967	614,334	424,768	622,216	832,508	232,233	587,164	7,359,055
Disbursements:													
Grants and subsidies	586,290	352,394	274,506	308,286	261,746	163,896	213,921	173,383	142,341	166,743	149,144	214,310	3,006,961
Personal services	328,791	312,066	322,532	317,859	303,896	368,243	293,442	281,065	287,581	283,786	316,556	184,693	3,600,509
Other services	53,463	87,500	101,303	48,414	34,050	42,480	66,209	74,992	53,733	32,954	60,662	80,684	736,444
Materials and supplies	10,820	9,974	12,262	15,003	16,245	15,425	10,805	14,474	13,901	9,415	14,651	12,854	155,828
Equipment purchases	1,416	3,545	3,430	2,319	2,201	3,499	1,379	2,673	1,992	2,099	2,551	4,091	31,196
Total disbursements	980,780	765,478	714,032	691,882	618,137	593,544	585,757	546,588	499,548	494,997	543,564	496,632	7,530,938
Total available cash less transfers and disbursements	(528,246)	(66,360)	(100,956)	395,938	(136,820)	118,423	28,577	(121,820)	122,668	337,511	(311,331)	90,532	(171,883)
Ending Cash Balance	\$ (292,474)	\$ (358,834)	\$ (459,790)	\$ (63,852)	\$ (200,671)	\$ (82,248)	\$ (53,671)	\$ (175,491)	\$ (52,823)	\$ 284,689	\$ (26,642)	\$ 63,890	\$ 63,890
Ending cash balance without considering TRANS	\$ (292,474)	\$ (358,834)	\$ (459,790)	\$ (868,296)	\$ (1,005,115)	\$ (886,692)	\$ (858,115)	\$ (979,935)	\$ (857,267)	\$ (247,588)	\$ (286,752)	\$ 75,946	

- (1) Budget.
- (2) Consists of net revenue from General Fund's non budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
- (3) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly to the Redemption Fund from non-General Fund revenues.
- (4) Consists of proceeds of borrowings from Government Development Bank and proceeds from Commonwealth's Tax and Revenue Anticipation Notes.
- (5) Consists of repayment of borrowings from Government Development Bank and repayment of Commonwealth's Tax and Revenue Anticipation Notes.

Source: Department of Treasury

TAX MATTERS

Federal Income Taxes

The Internal Revenue Code of 1986, as amended (the “Code”), imposes certain requirements that must be met subsequent to the issuance and delivery of the Notes for interest thereon to be and remain excluded from gross income for Federal income tax purposes. Noncompliance with such requirements could cause the interest on the Notes to be included in gross income for Federal income tax purposes retroactive to the date of issue of the Notes. The Commonwealth has covenanted to comply with the applicable requirements of the Code in order to maintain the exclusion of the interest on the Notes from gross income for Federal income tax purposes pursuant to Section 103 of the Code. In addition, the Commonwealth has made certain representations and certifications in the Tax Certificate as to Arbitrage and the Provisions of Section 141-150 of the Internal Revenue Code of 1986.

In the opinion of Nixon Peabody LLP, Bond Counsel, under existing law and assuming compliance with the aforementioned covenant, and the accuracy of certain representations and certifications made by the Commonwealth described above, interest on the Notes is excluded from gross income for Federal income tax purposes under Section 103 of the Code. Bond Counsel is also of the opinion that such interest is not treated as a preference item in calculating the alternative minimum tax imposed under the Code with respect to individuals and corporations. Interest on the Notes is, however, included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

Bond Counsel is also of the opinion that the Notes and the interest thereon are exempt from state, Commonwealth and local income taxation.

Original Issue Premium

The Notes are being offered at a price in excess of their principal amount. Bond Counsel is of the opinion that an initial purchaser with an initial adjusted basis in a Note in excess of its principal amount will have amortizable bond premium which is not deductible from gross income for Federal income taxes. The amount of amortizable bond premium for a taxable year is determined actuarially on a constant interest rate basis over the term of each Note based on the purchaser’s yield to maturity. For purposes of determining gain or loss on the sale or other disposition of a Note, an initial purchaser who acquires such obligation with an amortizable bond premium is required to decrease such purchaser’s adjusted basis in such Note annually by the amount of amortizable bond premium for the taxable year. The amortization of bond premium may be taken into account as a reduction in the amount of tax-exempt income for purposes of determining various other tax consequences of owning Notes. Owners of the Notes are advised that they should consult with their own advisors with respect to the state, Commonwealth and local tax consequences of owning the Notes.

Certain Federal Tax Information

General. The following is a discussion of certain additional tax matters under existing statutes. It does not purport to deal with all aspects of Federal taxation that may be relevant to particular investors. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Notes, as well as any tax consequences arising under the laws of any state or other taxing jurisdiction.

Social Security and Railroad Retirement Payments. The Code provides that interest on tax-exempt obligations is included in the calculation of modified adjusted gross income in determining whether a portion of Social Security or railroad retirement benefits received are to be included in taxable income.

Branch Profits Tax. The Code provides that interest on tax-exempt obligations is included in effectively connected earnings and profits for purposes of computing the branch profits tax on certain foreign corporations doing business in the United States.

Borrowed Funds. The Code provides that interest paid (or deemed paid) on borrowed funds used during a tax year to purchase or carry tax-exempt obligations is not deductible. In addition, under rules used by the Internal Revenue Service for determining when borrowed funds are considered used for the purpose of purchasing or carrying particular assets, the purchase of obligations may be considered to have been made with borrowed funds even though the borrowed funds are not directly traceable to the purchase of such obligations.

Property and Casualty Insurance Companies. The Code contains provisions relating to property and casualty insurance companies whereunder the amount of certain loss deductions otherwise allowed is reduced (in certain cases below zero) by a specified percentage of, among other things, interest on tax exempt obligations acquired after August 7, 1986.

Financial Institutions. The Code provides that commercial banks, thrift institutions and other financial institutions may not deduct the portion of their interest expense allocable to tax-exempt obligations acquired after August 7, 1986, other than certain “qualified” obligations. The Notes are not “qualified” obligations for this purpose.

S Corporations. The Code imposes a tax on excess net passive income of certain S corporations that have subchapter C earnings and profits. Interest on tax-exempt obligations must be included in passive investment income for purposes of this tax.

Earned Income Credit. For any taxable year beginning after December 31, 1995, the Code denies the earned income credit to persons otherwise eligible for it if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds \$2,200, subject to adjustment for inflation for taxable years beginning after December 31, 1996. Interest on the Notes will constitute disqualified income for this purpose.

Changes in Federal Tax Law and Post-Issuance Events. From time to time proposals are introduced in Congress that, if enacted into law, could have an adverse impact on the potential benefits of the exclusion from gross income for Federal income tax purposes of the interest on the Notes, and thus on the economic value of the Notes. This could result from reductions in Federal income tax rates, changes in the structure of the Federal income tax rates, changes in the structure of the Federal income tax or its replacement with another type of tax, repeal of the exclusion of the interest on the Notes from gross income for such purposes, or otherwise. It is not possible to predict whether any legislation having an adverse impact on the tax treatment of holders of the Notes may be proposed or enacted.

Bond Counsel has not undertaken to advise in the future whether any events after the date of issuance and delivery of the Notes may affect the tax status of interest on the Notes. Bond Counsel expresses no opinion as to any Federal, state, Commonwealth or local tax law consequences with respect to the Notes, or the interest thereon, if any action is taken with respect to the Notes or the proceeds thereof upon the advice or approval of other counsel.

LEGAL MATTERS

The proposed form of opinion of Nixon Peabody LLP, Bond Counsel, is set forth in *Appendix I* 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 Notes will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for insurance companies to qualify them to do business in Puerto Rico, as required by law.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Notes from the Commonwealth at an aggregate discount of \$973,169.22 from the initial offering price of the Notes. The obligations of the Underwriters are subject to certain conditions precedent, and the Underwriters will be obligated to purchase all the Notes, if any Notes are purchased. The Underwriters may offer to sell the Notes to certain dealers and others at prices lower than the initial public offering prices, and such offering price may be changed, from time to time, by the Underwriters.

Morgan Stanley & Co. Incorporated has entered into a written agreement with Popular Securities, Inc. pursuant to which Popular Securities has agreed to act as a consultant to Morgan Stanley in connection with Morgan Stanley's provision of underwriting and investment banking services to the Commonwealth with respect to the Notes. Pursuant to this agreement, the existence of which has been disclosed to the Commonwealth and Government Development Bank, Popular Securities will be entitled to receive a portion of Morgan Stanley's actual net profits, if any, in connection with the underwriting of the Notes. Other similar agreements with respect to the sharing of underwriting net profits have been entered into and disclosed to the Commonwealth and Government Development Bank by: Goldman, Sachs & Co. and FirstBank Puerto Rico, ABN Amro Financial Services, Inc. and Prudential Securities Incorporated and Banc of America Securities LLC and Oriental Financial Services Corp.

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 Commonwealth in connection with the Notes.

As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Notes. 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. and Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., have given the Notes ratings of MIG - 1 and SP - 1, respectively. The ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

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

There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies, if in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of such ratings, or either of them, may have an adverse effect on the market price of the Notes.

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the “Rule”), promulgated by the Securities and Exchange Commission (the “SEC”), the Commonwealth has covenanted in the Note Resolution for the benefit of the Underwriters and the Beneficial Owners as defined in such resolution and generally the tax owners of the Notes:

To file, in a timely manner, with each NRMSIR or with the MSRB and with any Commonwealth state information depository (“SID”), notice of the occurrence of any of the following events with respect to the Notes, if 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 Notes;
- g. modifications to rights of the holders (including Beneficial Owners) of the Notes;
- h. note calls;
- i. defeasances;
- j. release, substitution, or sale of property securing repayment of the Notes; and
- k. rating changes.

Events (c), (d), (e), (h) and (i) are included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. However, such events may not be applicable, since the terms of the Notes do not provide for “debt service reserves,” “credit enhancements” or “credit or liquidity providers” or for redemption and the Note Resolution does not contain any “defeasance” provisions. For a description of the Notes, see *The Notes*. In addition, with respect to the following events:

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

Event (f). For information on the tax status of the Notes, see *Tax Matters*.

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

The Commonwealth 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 Commonwealth, such other events are material with respect to the Notes, but the Commonwealth does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

The Commonwealth acknowledges that its undertaking described above is intended to be for the benefit of the Beneficial Owners of the Notes, and shall be enforceable by any such Beneficial Owner, provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of the Commonwealth's obligations hereunder. The Commonwealth has represented to the Underwriters that it has not failed to comply with any similar undertaking under the Rule.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity (“Proceeding”) for the enforcement of the foregoing covenant (the “Covenant”) or for any remedy for breach thereof, unless such Beneficial

Owner shall have filed with the Commonwealth written notice of any request to cure such breach, and the Commonwealth shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan, Puerto Rico, for the equal benefit of all Beneficial Owners of the outstanding Notes benefitted by the Covenant, and no remedy shall be sought or granted other than specific performance of the Covenant. Moreover, Proceedings filed by Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Section 2 of Act No. 104, approved June 19, 1955, as amended (32 L.P.R.A. § 3077 and § 3077a), which governs the scope of legal actions against the Commonwealth, substantially limits the amount of monetary damages that may be awarded against the Commonwealth and provides certain notice provisions, the failure to comply with which may further limit any recovery.

The Covenant 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 Commonwealth, or type of business conducted; the Covenant, as amended, would have complied with the requirements of the Rule at the time of award of the Notes, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interest of Beneficial Owners, as determined by parties unaffiliated with the Commonwealth; or

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

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

The Covenant has been made in order to assist the Underwriters in complying with the Rule.

MISCELLANEOUS

The foregoing summaries of or references to the various acts, the Notes, the Note Resolution and the summaries of or references to the various acts contained in the Commonwealth Report, 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.

Appended to and constituting a part of this Official Statement is the proposed form of opinion of Bond Counsel (*Appendix I*).

The information included in this Official Statement and incorporated herein by reference, except for information pertaining to DTC and the information appearing in *Underwriting*, was supplied by certain officials of the Commonwealth or certain of its agencies or instrumentalities, in their respective official capacities, or was obtained from publications of the Commonwealth or certain of its agencies or instrumentalities, and is included or incorporated by reference in this Official Statement on the authority of such officials or the authority of such publications as public official documents. The information pertaining to DTC was supplied by DTC.

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

COMMONWEALTH OF PUERTO RICO

By: /s/ Juan A. Flores Galarza
Secretary of the Treasury
of the Commonwealth of Puerto Rico

October 3, 2002

Hon. Juan A. Flores Galarza
Secretary of the Treasury of Puerto Rico
San Juan, Puerto Rico

Dear Sir:

We have acted as bond counsel in connection with the issuance by the Commonwealth of Puerto Rico (the "Commonwealth") of \$800,000,000 Tax and Revenue Anticipation Notes of the Commonwealth of Puerto Rico, Series 2003 (the "Notes"). The Notes are dated October 3, 2002, mature July 30, 2003, and bear interest at the rate of two and fifty hundredths per centum (2.50%) per annum, payable at maturity. The Notes are issuable as registered notes in denominations of \$5,000 and any multiple thereof and are issued under the provisions of Act No. 1 of the Legislature of Puerto Rico, approved June 26, 1987 (the "Act") and a resolution of the Secretary of the Treasury authorizing the issuance of the Notes (the "Note Resolution").

We have examined the law and such certified proceedings and other papers as we deem necessary to render the following opinions.

In rendering the following opinions we have assumed the genuineness of all signatures, the authenticity of all documents tendered to us as originals and the conformity to original documents of all documents submitted to us as certified or photostatic copies. As to questions of fact material to our opinion, we have relied upon the certified proceedings and other certifications of public officials furnished to us without undertaking to verify the same by independent investigation.

Based upon the foregoing, we are of the opinion, under existing law, as follows:

1. The Act is valid.
2. The proceedings authorizing the issuance of the Notes have been validly and legally taken.
3. The Notes have been duly authorized and issued to fund a portion of the Commonwealth's projected cash requirements for the remainder of the fiscal year ending June 30, 2003, which requirements result from timing differences between expected disbursements and receipts of revenues, and are valid and binding obligations of the Commonwealth payable

solely from the special fund created by the Act designated "Special Fund for the Redemption of Tax and Revenue Anticipation Notes," to the credit of which Fund the Secretary of the Treasury of Puerto Rico is required by and in the manner set forth in the Note Resolution to deposit all taxes and revenues required to be deposited in the General Fund of the Commonwealth received after March 31, 2003 and on or prior to June 30, 2003 plus any balance in the General Fund on April 1, 2003 in respect of taxes and revenues received by the General Fund after the date hereof (and if certain coverage requirements are not met, taxes and revenues so deposited prior to April 1, 2003), subject to certain prior applications as specified therein, sufficient to pay the principal of and interest on the Notes. The full faith, credit and taxing power of the Commonwealth are not pledged to the payments of the Notes.

4. The Internal Revenue Code of 1986, as amended (the "Code") sets forth certain requirements which must be met subsequent to the issuance and delivery of the Notes for interest thereon to be and remain excluded from gross income for Federal income tax purposes. Noncompliance with such requirements could cause the interest on the Notes to be included in gross income for Federal income tax purposes retroactively to the date of issue of the Notes. The Commonwealth has covenanted in the Note Resolution to comply, to the extent permitted by the Constitution and laws of the Commonwealth, with the requirements of the Code and the regulations promulgated thereunder to maintain the exclusion from gross income of the interest on the Notes pursuant to Section 103 of the Code. We are not aware of any provisions in said Constitution and laws that would prevent such compliance. In addition, the Commonwealth has made certain representations and certifications relating to the Notes in its "Tax Certificate as to Arbitrage and the Provisions of Sections 103 and 141-150 of the Internal Revenue Code of 1986" of even date herewith.

Under existing law, assuming compliance with the tax covenants described herein and the accuracy of certain representations and certifications made by the Commonwealth described above, interest on the Notes is excluded from gross income for Federal income tax purposes under Section 103 of the Code. We are also of the opinion that such interest is not treated as a preference item in calculating the alternative minimum tax imposed under the Code with respect to individuals and corporations. Interest on the Notes is, however, included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

5. The Notes are being offered at a price in excess of their principal amount. An initial purchaser with an initial adjusted basis in a Note in excess of its principal amount will have amortizable bond premium which is not deductible from gross income for Federal income tax purposes. The amount of amortizable bond premium for a taxable year is determined actuarially on a constant interest rate basis over the term of each Note based on the purchaser's yield to maturity. For purposes of determining gain or loss on the sale or other disposition of a Note, an initial purchaser who acquires such obligation with an amortizable bond premium is required to decrease such purchaser's adjusted basis in such Note annually by the amount of amortizable bond premium for the taxable year. The amortization of bond premium may be

Hon. Juan A. Flores Galarza
October 3, 2002
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taken into account as a reduction in the amount of tax-exempt income for purposes of determining various other tax consequences of owning Notes.

6. The interest on the Notes is exempt from state, Commonwealth and local income taxation.

Except as stated in paragraphs 4, 5 and 6 above, we express no opinion as to any other Federal or state, Commonwealth or local tax consequences of the ownership or disposition of the Notes. Furthermore, we express no opinion as to any Federal, state, Commonwealth or local tax law consequences with respect to the Notes, or the interest thereon, if any action is taken with respect to the Notes or the proceeds thereof upon the advice or approval of other bond counsel.

It is to be understood that the rights of the holders of the Notes and the enforceability thereof may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted to the extent constitutionally applicable and that their enforcement may also be subject to the exercise of judicial discretion in appropriate cases.

Very truly yours,

Nixon Peabody LLP