

**NEW ISSUE – BOOK-ENTRY ONLY**  
**See “BOOK-ENTRY ONLY SYSTEM”**

*In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, under the provisions of the Acts of Congress now in force, and under existing statutes and court decisions, (a) interest on the Series 2008A Bonds is included in gross income for Federal income tax purposes, except that no opinion is expressed with respect to certain federal income tax matters covered by the opinion of Fiddler, González & Rodríguez, P.S.C., Special Tax Counsel to the Corporation, delivered to the Corporation on the date of delivery of the Series 2008A Bonds, and (b) the Series 2008A Bonds, and the interest thereon, are exempt from state, Commonwealth of Puerto Rico and local taxation. In the opinion of Fiddler González & Rodríguez, P.S.C., Special Tax Counsel to the Corporation, (a) under the provisions of Commonwealth of Puerto Rico existing statutes and regulations now in force, the Series 2008A Bonds, and the interest thereon, are exempt from Commonwealth of Puerto Rico and local taxation and (b) under the provisions of existing Federal statutes and regulations now in force, under certain circumstances, interest on the Series 2008A Bonds will be exempt from United States taxation to individuals who are bona fide residents of the Commonwealth of Puerto Rico and corporations organized under the laws of the Commonwealth of Puerto Rico. See “TAX MATTERS” herein.*

**Puerto Rico Sales Tax Financing Corporation**  
**\$737,046,992.35 Sales Tax Revenue Bonds, Series 2008A**

**Dated:** Date of Delivery

**Due:** August 1, as shown on the inside cover page

Puerto Rico Sales Tax Financing Corporation (the “Corporation”) will issue its Sales Tax Revenue Bonds, Series 2008A (the “Series 2008A Bonds”), in order to provide funds to the Commonwealth of Puerto Rico (the “Commonwealth”) to be applied to the repayment of certain of its “extraconstitutional” debt.

The Series 2008A Bonds to be issued, bonds previously issued, and any additional bonds issued under resolutions adopted by the Corporation (collectively, as amended and supplemented, the “Resolution”), will be payable from and secured by a security interest created by the Resolution in a specified portion of a sales tax (such portion of the Commonwealth sales tax, the “Pledged Sales Tax”), imposed by a statute of the Commonwealth that grants to the Corporation ownership of the Pledged Sales Tax, such portion constituting the *first receipts* of such tax in each Fiscal Year in the specified amount. The Bank of New York will act as trustee (the “Trustee”) under the Resolution.

The Series 2008A Bonds are issuable as registered bonds without coupons in denominations of \$5,000 (of maturity amount in the case of the capital appreciation bonds), initially registered in the name of Cede & Co., as nominee for The Depository Trust Company. Purchasers of the Series 2008A Bonds will not receive certificates representing the Series 2008A Bonds. The Series 2008A Bonds are being issued as current interest bonds (the “Current Interest Bonds”) and capital appreciation bonds (the “Capital Appreciation Bonds”), as set forth in the inside cover page. Interest on the Current Interest Bonds will be payable monthly to maturity (or earlier redemption), commencing on August 1, 2008. Interest on the Capital Appreciation Bonds will not be payable on a current basis but will compound semiannually on each February 1 and August 1, commencing on August 1, 2008, and will be payable at maturity or redemption. The Series 2008A Bonds are subject to redemption prior to maturity as set forth herein, including redemption at par. The inside cover page of this Official Statement contains information concerning the maturity schedules, interest rates, prices and approximate yields of the Series 2008A Bonds.

THE SERIES 2008A BONDS ARE PAYABLE BY THE CORPORATION SOLELY FROM THE PLEDGED PROPERTY HELD UNDER THE RESOLUTION CONSISTING PRIMARILY OF THE PLEDGED SALES TAX COLLECTED AND REMITTED TO THE TRUSTEE. THE SERIES 2008A BONDS DO NOT CONSTITUTE A DEBT, OBLIGATION OR PLEDGE OF THE FULL FAITH, CREDIT AND TAXING POWER OF THE COMMONWEALTH OR ANY OF ITS MUNICIPALITIES OR POLITICAL SUBDIVISIONS OR INSTRUMENTALITIES (OTHER THAN THE CORPORATION), AND NEITHER THE COMMONWEALTH NOR ANY OF ITS MUNICIPALITIES OR POLITICAL SUBDIVISIONS NOR INSTRUMENTALITIES (OTHER THAN THE CORPORATION) SHALL BE LIABLE FOR THE PAYMENT THEREOF.

UBS Financial Services Incorporated of Puerto Rico (the “Principal”) will serve as agent for the Corporation. The Series 2008A Bonds will be placed by the Principal when, as and if issued by the Corporation. Certain legal matters will be passed upon by Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel to the Corporation, and Fiddler González & Rodríguez, P.S.C., San Juan, Puerto Rico, as Special Tax Counsel to the Corporation and as counsel to the Principal. It is expected that the Series 2008A Bonds will be delivered through The Depository Trust Company on or about June 26, 2008.

**UBS FINANCIAL SERVICES INCORPORATED OF PUERTO RICO**

June 25, 2008

**Puerto Rico Sales Tax Financing Corporation**  
**\$737,046,992.35 Sales Tax Revenue Bonds, Series 2008A**

**\$248,161,992.35 Capital Appreciation Bonds**

<b>Maturity Date August 1,</b>	<b>Initial Principal Amount</b>	<b>Maturity Amount</b>	<b>Yield to Maturity</b>
2024	\$22,406,534.40	\$ 60,155,000.00	6.23%
2025	33,212,087.60	94,805,000.00	6.23
2026	34,722,843.30	105,390,000.00	6.23
2027	16,414,833.50	52,975,000.00	6.23
2031	23,076,651.40	95,185,000.00	6.23
2032	22,470,385.50	98,550,000.00	6.23
2033	22,669,524.60	105,715,000.00	6.23
2034	21,581,776.80	107,010,000.00	6.23
2035	26,269,731.60	138,495,000.00	6.23
2036	25,337,623.65	142,035,000.00	6.23

**\$488,885,000.00 Current Interest Bonds**

\$33,000,000.00 6.13% Term Bonds due August 1, 2027; Price: 100%  
 \$74,030,000.00 6.13% Term Bonds due August 1, 2028; Price: 100%  
 \$91,015,000.00 6.13% Term Bonds due August 1, 2029; Price: 100%  
 \$80,825,000.00 6.13% Term Bonds due August 1, 2030; Price: 100%  
 \$111,880,000.00 6.13% Term Bonds due August 1, 2037; Price: 100%  
 \$98,135,000.00 6.13% Term Bonds due August 1, 2038; Price: 100%

No dealer, broker, sales representative or other person has been authorized by Puerto Rico Sales Tax Financing Corporation, Government Development Bank or the Principal to give any information or to make any representations, other than those contained in this Official Statement in connection with the offering described herein, and if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. 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 Series 2008A Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information contained herein has been obtained from Puerto Rico Sales Tax Financing Corporation, Government Development Bank, The Depository Trust Company, and other sources which are believed to be reliable but is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Principal. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of the Official Statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of Puerto Rico Sales Tax Financing Corporation or Government Development Bank since the date hereof. The Principal has reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal and Commonwealth securities laws as applied to the facts and circumstances of this transaction, but the Principal does not guarantee the accuracy or completeness of such information.

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**Puerto Rico Sales Tax Financing Corporation**  
**\$737,046,992.35 Sales Tax Revenue Bonds, Series 2008A**

**INTRODUCTION**

This Official Statement of Puerto Rico Sales Tax Financing Corporation (the “Corporation,” or as known by the acronym of its Spanish name, “COFINA”) sets forth certain information in connection with the issuance and sale by the Corporation of its \$737,046,992.35 Sales Tax Revenue Bonds, Series 2008A (the “Series 2008A Bonds”).

The Series 2008A Bonds will be issued pursuant to a Sales Tax Revenue Bond Resolution, as amended (the “General Resolution”), adopted on July 13, 2007, and a Fourth Supplemental Sales Tax Revenue Bond Resolution (together with the General Resolution, the “Resolution”), adopted by the Board of Directors of the Corporation on June 18, 2008, pursuant to which The Bank of New York will act as trustee (the “Trustee”). Immediately prior to the issuance of the Series 2008A Bonds, the Corporation will have outstanding \$4.5 billion of its Sales Tax Revenue Bonds (calculated by excluding all accretion on any existing capital appreciation bonds) issued under the Resolution, the First Supplemental Sales Tax Revenue Bond Resolution adopted by the Board of Directors of the Corporation on July 13, 2007, the Second Supplemental Sales Tax Revenue Bond Resolution adopted by the Board of Directors of the Corporation on July 17, 2007, and the Third Supplemental Sales Tax Revenue Bond Resolution adopted by the Board of Directors of the Corporation on December 18, 2007.

The Corporation is an independent governmental instrumentality of the Commonwealth of Puerto Rico (the “Commonwealth”), created under Act No. 91 of the Legislative Assembly of Puerto Rico, approved May 13, 2006, as amended by Act No. 291 approved December 26, 2006 and by Act No. 56 approved July 6, 2007 (“Act 91”), for the purpose of financing the payment, retirement or defeasance of certain debt obligations of the Commonwealth outstanding as of June 30, 2006, which are payable to Government Development Bank for Puerto Rico (“Government Development Bank”) and Puerto Rico Public Finance Corporation (“PFC”). Such Commonwealth debt obligations, which are payable solely from Commonwealth budgetary appropriations, are generally referred to as the “Extraconstitutional Debt.”

Legislation enacted by the Legislative Assembly of Puerto Rico in 2006 approved for the first time a sales and use tax, imposed at a 5.5% rate for the benefit of the Commonwealth (as well as an additional and separate 1.5% rate for the benefit of municipalities of the Commonwealth), on the sales or use of a broad range of goods and services in the Commonwealth (the tax generated by the 5.5% rate herein called the “Commonwealth Sales Tax”). Act 91 established the Dedicated Sales Tax Fund (as known by the acronym of its Spanish name, the “FIA Fund”), a special fund held and owned by the Corporation separate and apart from the Commonwealth’s General Fund, and provided, among other things, that each Fiscal Year the first receipts of the Commonwealth Sales Tax, in the amount specified in Act 91, be deposited in the FIA Fund and applied to the payment and retirement of the Extraconstitutional Debt outstanding as of June 30, 2006. See “*Pledged Sales Tax and FIA Fund*” in “PLEDGED SALES TAX” below.

Pursuant to the authority conferred under Act 91, the Corporation will issue the Series 2008A Bonds, will apply the net proceeds thereof for the payment and retirement of a portion of the Extraconstitutional Debt outstanding as of June 30, 2006, and will grant a security interest under the Resolution to the Pledged Sales Tax for the payment of the Series 2008A Bonds. The Series 2008A Bonds, the Series 2007A Bonds, the Series 2007B Bonds, the Series 2007C Bonds, and all other bonds issued under the Resolution will be payable from, and secured by a security interest granted under the Resolution in the Pledged Property, including the Pledged Sales Tax. The General Resolution allows for the issuance of additional bonds with payment priorities under the Resolution on a parity with, or subordinate to, the Series 2008A Bonds (such additional bonds and previously issued bonds, together with the Series 2008A Bonds, the “Bonds”).

THE SERIES 2008A BONDS ARE PAYABLE BY THE CORPORATION SOLELY FROM THE PLEDGED PROPERTY HELD UNDER THE RESOLUTION CONSISTING PRIMARILY OF THE PLEDGED SALES TAX. THE SERIES 2008A BONDS DO NOT CONSTITUTE A DEBT, OBLIGATION OR PLEDGE OF THE FULL FAITH, CREDIT AND TAXING POWER OF THE COMMONWEALTH OR ANY OF ITS MUNICIPALITIES OR POLITICAL SUBDIVISIONS OR INSTRUMENTALITIES (OTHER THAN THE CORPORATION), AND NEITHER THE COMMONWEALTH NOR ANY OF ITS MUNICIPALITIES OR POLITICAL SUBDIVISIONS NOR INSTRUMENTALITIES (OTHER THAN THE CORPORATION) SHALL BE LIABLE FOR THE PAYMENT THEREOF.

Brief descriptions of the Corporation, the security for the Bonds, the terms of the Series 2008A Bonds, and the provisions of the Resolution are included in this Official Statement. All references to the Resolution and other documents and agreements are qualified in their entirety by reference to such documents and agreements, copies of which are available for inspection at the offices of the Trustee.

This Official Statement contains certain “forward-looking statements” concerning the Corporation. These statements are based upon a number of assumptions and estimates that are subject to significant uncertainties, many of which are beyond the control of the Corporation. The words “may,” “would,” “could,” “will,” “expect,” “anticipate,” “believe,” “intend,” “plan,” “estimate” and similar expressions are meant to identify these forward-looking statements. Actual results may differ materially from those expressed or implied by these forward-looking statements.

Capitalized terms not defined elsewhere in this Official Statement are defined in *Appendix B*.

## THE CORPORATION

The Corporation is an independent governmental instrumentality of the Commonwealth created by Act 91 for the purpose of financing the payment, retirement or defeasance of the Extraconstitutional Debt outstanding as of June 30, 2006. Act 91 vested the Corporation with all the powers conferred to Government Development Bank under its charter (other than the power to act as fiscal agent), including the power to issue bonds for its corporate purposes, to the extent required in order for the Corporation to carry out the purposes for which it was created. The Corporation is also known by an acronym of its Spanish name -- “COFINA.” Act 91 provides that present and future collections of the Pledged Sales Tax be transferred to the Corporation in exchange for, and in consideration of, the Corporation’s commitment to pay, or establish mechanisms to pay, all or part of the Extraconstitutional Debt outstanding as of June 30, 2006 with the net proceeds of the bonds issued by the Corporation and with other funds and resources available to the Corporation. Act 91 provides that the board of directors of the Corporation (the “Governing Board”) shall consist of the members of the Board of Directors of Government Development Bank.

The following individuals are at present members of the Governing Board of the Corporation:

<u>Name</u>	<u>Occupation</u>
Ana I. Vilá	Certified Public Accountant
Luis A. Avilés Pagán, Esq.	Attorney
Rafael F. Martínez Margarida	Certified Public Accountant
Hon. Jorge Silva-Puras	Governor’s Chief of Staff
Ernesto A. Meléndez, Esq.	Attorney
José Guillermo Dávila	Certified Public Accountant
Armando A. Valdez	Executive Director, Office of Management and Budget

The Corporation’s offices are located at the offices of Government Development Bank at Roberto Sánchez Vilella Government Center, De Diego Avenue, Stop 22, Santurce, Puerto Rico 00940.

## THE SERIES 2008A BONDS

### General

The Series 2008A Bonds will be dated their date of delivery and will be issued in the aggregate initial principal amount of \$737,046,992.35, as current interest bonds (the “Current Interest Bonds”) and as capital appreciation bonds (the “Capital Appreciation Bonds”), in the principal amounts, bearing interest at the rates, or compounding at the yields (in the case of Capital Appreciation Bonds), and maturing (subject to the rights of redemption described below) on the dates, all as shown on the inside cover page of this Official Statement.

Interest on the Series 2008A Bonds will accrue, or compound (in the case of Capital Appreciation Bonds), from their date of delivery. Interest on the Current Interest Bonds will be payable monthly to maturity (or earlier redemption), commencing on August 1, 2008, and such interest shall be computed on a basis of a 360-day year consisting of twelve 30-day months. Interest on the Capital Appreciation Bonds, computed on a basis of a 360-day year consisting of twelve 30-day months, will not be paid on a current basis, but will be added to the principal in the form of Compounded Amount on each February 1 and August 1, commencing on August 1, 2008 (each a “Compounding Date”), and will be treated as if accruing in equal daily amounts between Compounding Dates, until payable at maturity or upon redemption.

For purposes of this Official Statement, references to “principal” shall mean, in the case of the Capital Appreciation Bonds, the Compounded Amount thereof.

The Series 2008A Bonds are issuable as fully registered bonds without coupons in denominations of \$5,000 and integral multiples thereof (or maturity amount in the case of the Capital Appreciation Bonds). The Series 2008A Bonds will be registered under The Depository Trust Company’s Book-Entry Only system described below. Certificated Series 2008A Bonds will not be available for distribution to the investing public. Transfers of ownership, and payment on the Series 2008A Bonds will be effected by The Depository Trust Company (“DTC”) and its Participants pursuant to rules and procedures established by DTC and its Participants. See “BOOK-ENTRY ONLY SYSTEM.”

Upon satisfaction of certain conditions contained in the Resolution, the Corporation may issue additional bonds secured on a parity with the Series 2008A Bonds and other Bonds or on a subordinate basis. See “*Additional Bonds, Refunding Bonds and Other Obligations*” under “SECURITY FOR THE BONDS”.

### Redemption

*Optional Redemption.* The Series 2008A Bonds are subject to redemption at the option of the Corporation from any source, including without limitation the proceeds of refunding bonds or other financing provided by the Corporation, in whole or in part, at any time on or after August 1, 2018, at a redemption price equal to the principal amount (in the case of Capital Appreciation Bonds, the Compounded Amount) of the Series 2008A Bonds, plus accrued interest to the redemption date, and without premium.

*Notice of Redemption.* In the event any Series 2008A Bonds are called for redemption, the Corporation shall give the Trustee notice (“Notice”) at least thirty (30) days prior to the date fixed for redemption (or such shorter period which is acceptable to the Trustee), and the Trustee shall give Notice, in the name of the Corporation, at least sixteen (16) days prior to the date fixed for redemption to DTC, or if the Book-Entry Only System is discontinued for any Series of Bonds as described above, to the registered owners of the Series 2008A Bonds or portions thereof to be redeemed (with copies to the Trustee); *provided, however*, that failure to give such Notice to DTC or to any registered owner, or any defect therein, shall not affect the validity of any proceedings for the redemption of any of the Series 2008A Bonds or portions thereof for which proper notice was given. If a Notice of redemption shall be unconditional, or if the conditions of a conditional Notice shall have been satisfied, then upon presentation and surrender of the Series 2008A Bonds or portions thereof so called for redemption at the place or places of payment, such Series 2008A Bonds or such portion shall be

redeemed.

The Notice shall (a) specify the (i) Series 2008A Bonds or portions thereof to be redeemed, (ii) redemption date, (iii) redemption price, (iv) place or places where amounts due upon such redemption will be payable (which shall be the principal office of the Trustee), and if less than all of the Series 2008A Bonds are to be redeemed, the CUSIP identification numbers, the numbers of the Series 2008A Bonds, and the portions of the Series 2008A Bonds to be redeemed, (b) state any condition permitted in, or not expressly prohibited by, the Resolution to such redemption, and (c) state that on the redemption date, and upon the satisfaction of any such condition, the Series 2008A Bonds or portions thereof to be redeemed shall cease to bear interest (in the case of the Capital Appreciation Bonds, the Compounded Amount thereof shall cease to increase).

Any notice of optional redemption of Series 2008A Bonds may be made conditional upon receipt by the Trustee on or prior to the date fixed for redemption of moneys sufficient to pay the principal of (or Compounded Amount, in the case of the Capital Appreciation Bonds) and interest on such Series 2008A Bonds or such portions to be redeemed, or upon the satisfaction of any other condition or the occurrence of any other event, which notice shall specify any such conditions or events. Any conditional notice so given may be rescinded at any time before payment of such principal of (or Compounded Amount, in the case of the Capital Appreciation Bonds) and interest on such Series 2008A Bonds or such portions thereof if any such condition so specified is not satisfied or if any such other event shall not occur. Notice of such rescission shall be given by the Corporation to the Trustee at least two (2) Business Days prior to the scheduled date of redemption, and the Trustee shall give notice of such rescission to affected Owners of the Series 2008A Bonds at least one (1) Business Day prior to such scheduled date of redemption, in the same manner as the conditional notice of redemption was given.

If notice of redemption is given and if sufficient funds are on deposit with the Trustee to provide for the payment of the principal of (or Compounded Amount, in the case of the Capital Appreciation Bonds) and premium, if any, and interest on the Series 2008A Bonds (or portions thereof) to be redeemed, then the Series 2008A Bonds (or portions thereof) so called for redemption will, on the redemption date, cease to bear interest (in the case of the Capital Appreciation Bonds, the Compounded Amount thereof shall cease to increase), and shall no longer be deemed outstanding under or be entitled to any benefit or security under the Resolution.

### **BOOK-ENTRY ONLY SYSTEM**

The information contained in *Appendix E* to this Official Statement concerning DTC and DTC's book-entry only system has been obtained from sources that the Corporation and the Principal believe to be reliable, but neither the Corporation nor the Principal take responsibility for the accuracy thereof.

The Corporation cannot and does not give any assurances that DTC, DTC Direct or Indirect Participants will distribute to the Beneficial Owners of the Series 2008A Bonds: (i) payments of principal and interest payments (including redemption payments) with respect to the Series 2008A Bonds; (ii) confirmation of ownership interest in the Series 2008A Bonds; or (iii) notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2008A Bonds, or that they will do so on a timely basis, or that DTC or the DTC Participants will serve and act in the manner described in this Official Statement.

None of the Corporation nor the Trustee or any agent of the Corporation or the Trustee will have any responsibility or obligations to DTC, the DTC Participants, or the Beneficial Owners with respect to: (i) the accuracy of any records maintained by DTC or any DTC Participants; (ii) the payment by DTC or any DTC Participants of any amount due to any Beneficial Owner in respect of principal and interest payments (including redemption payments) on the Series 2008A Bonds; (iii) the delivery by DTC or any DTC Participants of any notice to any Beneficial Owner that is required or permitted to be given to owners under the terms of the Series 2008A Bonds; or (iv) any consent given or other action taken by DTC as registered owner of the Series 2008A Bonds. See *Appendix E-Book-Entry System*.

## ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds are expected to be as follows:

### Sources

Principal Amount of the Series 2008A Bonds	\$737,046,992.35
Cash Payment-Accrued Interest	3,002,930.03
<b>Total Sources</b>	<b>\$740,050,438.29</b>

### Uses

Payment of Extraconstitutional Debt	\$732,292,769.25
Principal's Fee	2,948,187.97
Other Costs of Issuance	1,806,035.13
Accrued Interest of Portfolio	3,002,930.03
<b>Total Uses</b>	<b>\$740,050,438.29</b>

## PLEGDED SALES TAX

### Commonwealth Sales Tax

By virtue of Act No. 117 of the Legislative Assembly of Puerto Rico, approved July 4, 2006 (the "Tax Reform Legislation"), the Legislative Assembly of Puerto Rico approved for the first time a Commonwealth sales tax at a rate of 5.5%, which is imposed on the sale of a wide range of goods and delivery of various services, as well as a separate sales tax to be imposed by the municipalities. The enactment of the Commonwealth Sales Tax in the amount of 5.5% on the sale price of the item or services subject to tax was confirmed by the Supreme Court of Puerto Rico by decision rendered on November 10, 2006.

Items subject to Commonwealth Sales Tax consist of "tangible personal property," "taxable services," and "admission fees." The Secretary of the Treasury has the authority to establish by regulation the conditions for exemption from the tax. The tax applies in general to the following items: (a) clothing and accessories, (b) furniture and appliances, (c) electronics, (d) any tangible good not otherwise exempted, (e) phone service, cable TV, (f) alcoholic beverages and tobacco, (g) prepared foods (including fast foods and other restaurants), (h) personal services, such as laundry, barber and beauty shops, and (i) all non-prescription medicines and nutritional supplements. Among other exemptions, the following items are exempt from the tax: (i) taxable items sold for use and consumption outside Puerto Rico, even if the sale occurs in Puerto Rico (i.e., exportation), (ii) taxable items "in transit" (i.e., brought to Puerto Rico in connection with productions of films, constructions, trade shows or other ends, which are re-exported from Puerto Rico by the same person who imported them), (iii) healthcare services and prescription medicines, (iv) housing units, (v) non-prepared food, (vi) crude oil and its derivatives, including gasoline, (vii) motor vehicles, (viii) services provided by designated professionals, (ix) financial services, (x) services provided by the Commonwealth, including electricity and water, (xi) purchases of special items or devices for persons with certain disabilities, (xii) purchase of raw materials and machinery and equipment used for the manufacturing of finished goods or products, (xiii) items sold in airports and marine ports to persons traveling outside the jurisdictional limits of Puerto Rico, (xiv) foods and prepared foods served in hospitals and other health care facilities and in schools, (xv) prescription medicines, (xvi) admissions to athletic or other events sponsored by schools, universities or colleges, (xvii) purchase of foods or taxable items made under the Nutritional Assistance Program or similar program, and (xviii) rental of real property for commercial purposes as student housing and by an individual for his/her main residence.

Merchants are required to collect the Commonwealth Sales Tax from the consumer; otherwise, the consumer is required to pay the tax. Any person who transacts business in Puerto Rico as a merchant must



request and receive a Merchants' Registration Certificate issued by the Secretary of the Treasury which appoints the merchant as a Commonwealth Sales Tax collection agent. Failure to request a Merchants' Registration Certificate subjects the merchant to fines. The Secretary of the Treasury may require that the merchant post a cash deposit, bond or other item of value as a condition to obtaining or retaining a Merchants' Registration Certificate. The Commonwealth Sales Tax is required to be remitted to the Secretary of the Treasury no later than the 20<sup>th</sup> day of the calendar month following the month in which the taxable transaction occurred, unless otherwise provided in regulations adopted by the Secretary of the Treasury. Each merchant is required to file a Sales and Use Tax Monthly Return to the Secretary of the Treasury no later than the 20<sup>th</sup> day of each month. Certain large merchants are required to file their return electronically. Annually, every merchant dedicated to a business or industry that was a merchant at any time during its taxable year must file a Sales and Use Tax Annual Return no later than the 15<sup>th</sup> day of the third month following the end of its taxable year. As of May 30, 2008, 372,000 merchants were registered at the Treasury Department.

### **Sales Tax Revenue Projections and Actual Collections**

The Commonwealth Sales Tax went into effect on November 15, 2006. For the seven and one half month period from November 15, 2006 through June 30, 2007 of Fiscal Year 2006-2007, the total Commonwealth Sales Tax collections was \$713.3 million (an average of \$95.1 million per month).

Commonwealth Sales Tax revenue projections for Fiscal Year 2007-2008 equal \$1.1 billion, or an average of \$93.1 million per month. Total Commonwealth Sales Tax collections from July 1, 2007 through April 30, 2008 was \$942.7 million (an average of \$94.3 million per month), representing a projected increase of approximately \$9.2 million from the Commonwealth Sales Tax revenue projections for the same period. As of April 2008, seventy-five percent of the collections from the Commonwealth Sales Tax are received electronically.

The Commonwealth Sales Tax revenue projections for Fiscal Year 2008 referred to above were made based on the Commonwealth's economic outlook as presented by the Planning Board on February 2007.

### **Pledged Sales Tax and FIA Fund**

The portion of the Commonwealth Sales Tax that is pledged under the Resolution as security for the payment of all bonds outstanding under the Resolution (the "Pledged Sales Tax"), principally consists of the first collections of the Commonwealth Sales Tax in each Fiscal Year up to the greater of (i) the product of the amount of the sales tax collected during the Fiscal Year multiplied by a fraction, the numerator of which is 1% and the denominator of which is the Commonwealth Sales Tax rate (at present, 5.5%: the amount resulting from such multiplication is sometimes referred to herein as the "1% formula"), and (ii) a minimum amount, referred to in the Resolution and herein as the "Pledged Sales Tax Base Amount."

Regardless of the level of sales tax collections based on the 1% share, Act 91 requires that all of the 5.5% Commonwealth Sales Tax be applied to satisfy and fund the Pledged Sales Tax Base Amount before any amounts are transferred to the Commonwealth General Fund.

The Pledged Sales Tax Base Amount for the Fiscal Year beginning July 1, 2007, is \$185,000,000. Pursuant to Act 91, the Pledged Sales Tax Base Amount increases each Fiscal Year thereafter at a statutory rate of 4%. In addition, Act 91 provides that if the amounts described in the first paragraph of this subsection were insufficient to pay principal of or interest on bonds or other debt obligations of the Corporation or to make any other payment related to obligations incurred with respect to bonds or other debt obligations, including interest rate swap agreements, such insufficiency shall be paid to the Corporation for deposit in the FIA Fund as additional Pledged Sales Tax from the first receipts of the Commonwealth Sales Tax collected in subsequent Fiscal Years which is in excess of the amounts described in the first paragraph of this subsection received during such Fiscal Year. See also "*Funds and Accounts Under the Resolution*" under "SECURITY FOR THE BONDS."

Act 91 creates the FIA Fund and requires that the Pledged Sales Tax be deposited into the FIA Fund. Under the provisions of Act 91, the FIA Fund and all present and future collections of the Pledged Sales Tax are transferred to, and made the property of, the Corporation in consideration for the Corporation's commitment to pay and retire, directly or indirectly, all or part of the Extraconstitutional Debt outstanding as of June 30, 2006. The FIA Fund is administered by the Government Development Bank and the Secretary of the Treasury.

During Fiscal Year 2007-2008 and subsequent Fiscal Years, the first collections of the Commonwealth Sales Tax, up to the Pledged Sales Tax Base Amount, are required to be deposited as received into the FIA Fund (or other fund maintained for that purpose under the Resolution). On a monthly basis, the Secretary of the Treasury is required to determine, based on actual Commonwealth Sales Tax collections, whether the amount of Commonwealth Sales Tax required to be transferred to the FIA Fund on the basis of the 1% formula, exceeds the applicable Pledged Sales Tax Base Amount and, if so, is required to deposit into the FIA Fund all Commonwealth Sales Tax collections received after such determination in an amount equal to such excess. On or prior to October 1 of each Fiscal Year, the Secretary of the Treasury is required to determine whether the amount of Commonwealth Sales Tax required to be transferred to the FIA Fund on the basis of the 1% formula during the prior Fiscal Year exceeded the applicable Pledged Sales Tax Base Amount and, if so, Act 91 requires that all Commonwealth Sales Tax collections of the prior Fiscal Year representing such excess be transferred to the FIA Fund (to the extent not previously transferred).

### **Procedures for the Collection and Deposit of the Pledged Sales Tax to the FIA Fund**

The procedures implemented by the Treasury Department in order to comply with the funding requirements of Act 91 are the following:

- The merchant or retailer files the return and pays the Commonwealth Sales Tax collected on a monthly basis to First Data Corp., a provider of electronic commerce and payment solutions for businesses and consumers ("First Data"), Banco Popular de Puerto Rico, a leading commercial banking institution in the Commonwealth and the Caribbean ("Banco Popular") or any other collector of the Commonwealth Sales Tax designated by the Secretary of the Treasury (the "Authorized Collectors").
- If the merchant files the return and pays the Commonwealth Sales Tax collected to First Data, after the receipt thereof, First Data sends, on a daily basis, (i) the Commonwealth Sales Tax collected by the merchant or retailer directly to a bridge account at Banco Popular in the name of the Treasury Department, as paying/receiving agent, and (ii) the 1.5% municipal sales tax to the municipalities\*.
- If the merchant pays the Commonwealth Sales Tax collected to any other Authorized Collector (other than First Data), such Authorized Collectors are required to transfer such payment on a daily basis to a bridge account at Banco Popular in the name of the Treasury Department, as paying/receiving agent.
- Once the moneys are deposited in the bridge account at Banco Popular, Banco Popular then transfers on a daily basis (with a 2 day delay) to the Trustee all Commonwealth Sales Tax collections (See "*Funds and Accounts Under the Resolution*" under "SECURITY FOR THE BONDS") until the Pledged Sales Tax Base Amount has been deposited in the Revenue Account and, thereafter, to the Treasury Department all subsequent Commonwealth Sales Tax collections until such time as the Treasury Department has received its share (4.5% of the 5.5%)

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\* Act No. 80 of July 29, 2007, requires the municipalities to impose and collect the municipal sales tax at a rate of 1.5% (1% to be collected by the municipalities directly or through a third party and 0.5% to be collected by the Secretary of the Treasury and to be deposited in certain special funds or accounts at GDB for the benefit of the municipalities).

of the collections received to date in the Fiscal Year. Thereafter, Banco Popular divides additional receipts of the Commonwealth Sales Tax between the Revenue Account and the Treasury on the basis of the 1%/4.5% split.

## **SECURITY FOR THE BONDS**

### **General**

Pursuant to the Resolution, the Bonds are limited obligations of the Corporation payable solely from, and secured by a grant of a security interest in the Pledged Property. The Resolution prohibits the issuance of any bonds or notes with a payment priority under the Resolution that is senior to the Series 2008A Bonds. The Resolution permits the issuance of bonds or notes with a payment priority under the Resolution that is on a parity with the Series 2008A Bonds or subordinate to the Series 2008A Bonds.

### **Property Pledged for the Payment of the Series 2008A Bonds**

Pledged Property consists of (i) all Revenues, and all right, title and interest of the Corporation in and to the Revenues and all rights to receive the same, (ii) the Funds and Accounts (other than the Costs of Issuance Account and the Rebate Account) held by the Trustee, and moneys and securities and, in the case of the Debt Service Reserve Account, Reserve Account Cash Equivalents, from time to time held by the Trustee under the terms of the Resolution, subject to the application thereof as provided in the Resolution, (iii) any and all other rights and property of every kind and nature from time to time pledged by the Corporation to the Trustee under the Resolution as and for additional security for the Series 2008A Bonds and Parity Obligations, and (iv) any an all cash and non-cash proceeds, products, offspring, rents, and profits from any of the Pledged Property mentioned described in paragraphs (i) through (iii) above, including, without limitation, those from the sale, exchange, transfer, collection, loss, damage, disposition, substitution or replacement of any of the foregoing. Revenues consist of (i) all Pledged Sales Tax collections received by the Corporation or the Trustee, (ii) with respect to any particular Bond, the proceeds of any draw on or payment under any Credit Facility which is intended for the payment of such Bond, but only for purpose of such payment, (iii) any amounts received by the Corporation pursuant to a Qualified Hedge, if any, after giving effect to any netting of amounts payable by the parties thereunder, (iv) income and interest earned and gains realized in excess of losses suffered by any Fund or Account (other than the Costs of Issuance Account and the Rebate Account) held by the Trustee, and (v) any other revenues, fees, charges, surcharges, rents, proceeds or other income and receipts received by or on behalf of the Corporation or by the Trustee, lawfully available for the purposes of the Resolution and deposited by or on behalf of the Corporation or by the Trustee in any Fund or Account (other than the Costs of Issuance Account and the Rebate Account) held by the Trustee.

The Corporation covenants that it will not issue any bonds, notes or other evidences of indebtedness secured by a pledge of or lien upon the Pledged Property, and shall not otherwise create any lien or charge on the Pledged Property, other than as permitted by the Resolution.

### **Funds and Accounts under the Resolution**

The Resolution provides for the creation of the "Repayment Project Fund" and, therein: a Costs of Issuance Account, a Capitalized Interest Account, a Bond Proceeds Account, a Revenue Account, a Debt Service Account, a Debt Service Reserve Account, a Redemption Account, and a Rebate Account, each to be held by the Trustee. All such Accounts, other than the Costs of Issuance Account and the Rebate Account, are subject to the lien and pledge created under the Resolution.

Under the Resolution, all Revenues received shall be deposited into the Revenue Account except for certain investment earnings and income which flow to the Rebate Account; *provided, however*, that the proceeds of any draw on or payment under any Credit Facility which is intended for the payment of a Bond may be applied directly to such payment or deposited directly to the Debt Service Account for such purpose. In addition,

there shall be deposited in the Revenue Account all other amounts required by the Resolution to be so deposited. Amounts on deposit from time to time in the Revenue Account shall be withdrawn and transferred as of the last Business Day of each calendar month as follows and in the following order or priority: (i) to the payment of regularly scheduled fees of the Trustee, and the payment of Operating Expenses (not to exceed the Operating Cap), (ii) to the Debt Service Account established for the Senior Bonds and Parity Obligations, all amounts until the amounts on deposit in such Debt Service Account shall equal the Accrued Payment Obligation related to the Senior Bonds and Parity Obligations, (iii) to the Debt Service Reserve Account established for the Senior Bonds, the amount required to cause the amount on deposit therein to be at least equal to the Debt Service Reserve Requirement for the Senior Bonds, (iv) to the Debt Service Accounts established for Subordinate Bonds and Subordinate Obligations, all amounts until the amounts on deposit in such Debt Service Accounts shall equal the Accrued Payment Obligation related to the Subordinate Bonds and Subordinate Obligations, (v) to the Debt Service Reserve Accounts established for the Subordinate Bonds, the amount required to cause the amount on deposit therein to be at least equal to the Debt Service Reserve Requirement for the Subordinate Bonds, and (vi) the balance, if any, shall be applied as follows upon written direction of the Corporation to the Trustee: provided that an amount at least equal to the Accrued Payment Obligation for all Senior Bonds, Subordinate Bonds, Parity Obligations and Subordinate Obligations for the ensuing twelve-month period (fifteen-month period for any Senior Bonds, Subordinate Bonds, Parity Obligations or Subordinate Obligations that have Principal Installments, interest or other scheduled principal or interest components due on a basis more frequently than semi-annually) shall be on deposit in the Debt Service Accounts pursuant to paragraph (ii) and (iv) above, (x) to pay or provide for the payment of amounts payable under Credit Facilities, Liquidity Facilities and Qualified Hedges not otherwise required to be funded pursuant to paragraphs (ii) and (iv) above, until such amounts shall be fully paid or otherwise provided for from this or any other source, then (y) at the direction of the Corporation (i) retained in the Revenue Account, (ii) transferred to the Redemption Account, or (iii) used for (I) the payment or reimbursement of Financing Costs, and for the payment of Operating Expenses in excess of the Operating Cap, (II) the purchase of Series 2008A Bonds, (III) deposits to the Bond Proceeds Account or (IV) any combination of the foregoing, and then (z) for release to the Corporation, free and clear of the lien of the Resolution, to be applied for any lawful purpose of the Corporation.

Purchases of Bonds from amounts in the Revenue Account shall be made upon the written direction of an Authorized Officer of the Corporation, with or without advertisement and with or without notice to other Bondowners. Such purchases shall be made at such price or prices as determined by such written instructions. If Sinking Fund Installments have been established for the maturities of Bonds purchased by the Corporation, then the Trustee, upon written instructions from an Authorized Officer of the Corporation, shall credit the principal amount purchased against future Sinking Fund Installments in direct chronological order, unless otherwise instructed in writing by an Authorized Officer of the Corporation at the time of such purchase.

### **Additional Bonds, Refunding Bonds and Other Obligations**

The Resolution permits the issuance of bonds in addition to the Senior Bonds (a) to finance the payment or retirement of Extraconstitutional Debt outstanding on June 30, 2006, or (b) to refund or otherwise prepay any bonds issued under the Resolution.

The Resolution permits the issuance of additional Bonds as Senior Bonds (i.e., with payment priorities on a parity with those of the Bonds) or as Subordinate Bonds (i.e., with payment priorities subordinate to those of the Bonds).

Additional Senior Bonds may not be issued and additional Parity Obligations may not be incurred under the Resolution unless the Corporation shall have filed with the Trustee a certificate of an Authorized Officer of the Corporation reflecting:

- A. (i) the Pledged Sales Tax Base Amount applicable to the Fiscal Year in which such additional Senior Bonds are to be issued or Parity Obligations are to be incurred, (ii) the Accrued Payment Obligation due on the Senior Bonds, including such additional Senior Bonds, the amount of

such Parity Obligations due, and the Operating Cap applicable, in such Fiscal Year, (iii) the Pledged Sales Tax Base Amount for each subsequent Fiscal Year taking into account the four percent (4%) minimum adjustment thereto provided in Act 91 and applicable to each Fiscal Year beginning July 1, 2008, and (iv) the Accrued Payment Obligation that will be due on the Senior Bonds, including such additional Senior Bonds, the amount of such Parity Obligations due, and the Operating Cap applicable, in each subsequent Fiscal Year, and showing that the amount in clause (i) at least equals the amount in clause (ii) and the amount for each subsequent Fiscal Year in clause (iii) at least equals the amount for such Fiscal Year in clause (iv).

B. (i) the total amount of Commonwealth Sales Tax assumed to be received in each Fiscal Year during which Senior Bonds and Parity Obligations, including such additional Senior Bonds or additional Parity Obligations, are to be outstanding under the Resolution, based on the assumption that the Commonwealth Sales Tax actually received in the Fiscal Year immediately preceding the date of issuance of such additional Senior Bonds or incurrence of such additional Parity Obligations is to be increased for each subsequent Fiscal Year by 4%, and (ii) the total Accrued Payment Obligation scheduled for all Outstanding Senior Bonds and amounts due on all Parity Obligations, including such additional Senior Bonds and additional Parity Obligations, in each such Fiscal Year, and showing, for each such Fiscal Year, that the related amount shown in (B)(i) is at least 3 times the related amount shown in (B)(ii).

In the event that amounts are paid to providers of Qualified Hedges, Credit Facilities or Liquidity Facilities pursuant to the transfers of funds required by the Resolution which do not represent scheduled payments or reimbursements in accordance with the terms of the related contracts, but represent costs, indemnities, termination payments or similar non-recurring amounts, or in the event such unscheduled amounts are due to such providers and there are insufficient funds held under the Resolution and available for the payment thereof, the Corporation shall provide written notice thereof to the Secretary of the Treasury and to the Director of the Office of Management and Budget. Pursuant to the authority of Act 91, such notice to the Secretary of the Treasury shall include the instruction to provide funds to the Trustee for the payment or reimbursement of such payments, from the first Dedicated Sales Tax collected in the next ensuing Fiscal Year after making the deposits required by Article 3(a) of Act 91 and, to the extent such amounts are insufficient to make a complete reimbursement thereof, from the first Dedicated Sales Taxes received in subsequent Fiscal Years after making the deposits required by Article 3(a) of Act 91. Any such amounts paid by the Secretary of the Treasury shall be deposited in the Revenue Account.

Subordinate Bonds may be issued in varying Classes with varying subordinate payment priorities under the Resolution without compliance with any particular debt service test under the Resolution. If any such Subordinate Bonds are issued, the Resolution provides for the creation of individual Debt Service Accounts and Debt Service Reserve Accounts for each such Class, in addition to the Debt Service Account for the Series 2008A Bonds, and the flow of funds from the Revenue Account described above will be made in the order of Senior Bonds first, and then Subordinate Bonds based on their respective payment priorities under the Resolution.

Owners of Subordinate Bonds or obligees under Subordinate Obligations may not declare an Event of Default, or cause the Trustee to take any remedial actions in the event such Subordinate Bonds or Subordinate Obligations are not timely paid amounts due, during any period that Senior Bonds or Parity Obligations are outstanding under the Resolution.

### **Commonwealth's Authority to Cover Deficiencies**

If the sales tax collections received by the FIA Fund in a Fiscal Year are less than the applicable Pledged Sales Tax Base Amount, Act 91 authorizes the Secretary of the Treasury to fund the shortfall from any available funds (including funds derived from borrowings from Government Development Bank) and requires the Director of the Office of Management and Budget of the Commonwealth, if such funding is made, to include

in the Commonwealth's budget for the current or the next Fiscal Year the appropriations necessary to cover the deficiency. Such deficiencies may be funded from available resources of the Commonwealth and, therefore, may be subject to the limitations provided under Section 8 of Article VI of the Constitution of Puerto Rico discussed below. **This Official Statement is not intended to provide information regarding the financial condition or financial prospects of the Commonwealth or its General Fund.**

### **Special Investment Considerations**

*Legal Considerations.* Section 8 of Article VI of the Constitution of Puerto Rico provides that if, in any Fiscal Year, the Commonwealth's "available resources including surplus" are insufficient to meet the appropriations made for that Fiscal Year, interest on the public debt (which for purposes of the Constitution includes general obligation bonds and notes of the Commonwealth and any payments required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public instrumentalities) must be paid first and other disbursements are to be made in accordance with priorities established by law. The Statement of Motives of Act No. 56 of July 6, 2007, which amended Act 91, states that it is the intent of the Legislative Assembly that the moneys deposited in the FIA Fund (i) belong to the Corporation and (ii) do not constitute available resources of the Commonwealth for any purpose, including for the purposes set forth in Section 8 of Article VI of the Constitution. In addition, Act 91 states that the FIA Fund is to be transferred to, and shall be the property of, the Corporation and provides further that the Pledged Sales Tax will (i) not constitute resources available to the Commonwealth, (ii) not be available for use by the Secretary of the Treasury, and (iii) be deposited in the FIA Fund upon receipt and will not be deposited into the Commonwealth's General Fund.

Act 91 has not been challenged in any court of law and the Supreme Court of Puerto Rico has not expressed itself as to (i) the constitutionality of the transfer of the Pledged Sales Tax to the Corporation as provided in Act 91; or (ii) whether the Pledged Sales Tax constitutes available resources of the Commonwealth for purposes of Section 8 of Article VI of the Constitution.

On July 31, 2007, the Secretary of Justice of the Commonwealth of Puerto Rico (who acts as attorney general for the Commonwealth) issued an opinion stating that (i) Act 91 is a valid enactment of law by the Commonwealth, (ii) the Pledged Sales Tax will not constitute "available resources" of the Commonwealth for any purpose, including for purposes of Section 8 of Article VI of the Constitution, and (iii) the Pledged Sales Tax cannot be applied to cover debt service of the Commonwealth's general obligation bonds or guaranteed debt under the circumstances contemplated by Section 8 of Article VI of the Constitution.

*Other Considerations.* Section 2 of Article VI of the Constitution of the Commonwealth of Puerto Rico states that the power of the Commonwealth to impose and collect taxes and to authorize their imposition and collection by municipalities shall be exercised as determined by the Legislative Assembly and shall never be surrendered or suspended. Therefore, the Legislative Assembly of the Commonwealth may amend, modify or repeal Act No. 117 of the Legislative Assembly of Puerto Rico, approved July 4, 2006 (the "Tax Reform Legislation"), which created the Commonwealth Sales Tax, and which is imposed on the sale of a wide range of goods and delivery of various services. See "PLEGGED SALES TAX—Recent Legislative Developments."

### **Commonwealth Non-Impairment Covenant**

Pursuant to Act 91, the Commonwealth agrees and commits with any person, firm or corporation or with any agency of the United States or of any other state or the Commonwealth or any country which acquires the Series 2008A Bonds that it will not limit or restrain the rights and powers conferred by Act 91 or the rights of the Corporation to comply with its agreements with Bondowners until said Series 2008A Bonds, together with the interest thereon, are completely retired and that no amendment to Act 91 shall impair any obligation or commitment of the Corporation.

## **RECENT DEVELOPMENTS**

### **Proposed Changes to the Commonwealth Sales Tax**

On February 6, 2008, the Governor of Puerto Rico, in his State of the Commonwealth address, proposed suspending the collection of a portion of the Commonwealth Sales Tax and replace such collections with the imposition of a new excise tax on goods imported into Puerto Rico in order to help stimulate Commonwealth's economy.

On February 7, 2008, the Governor stated that any proposal from his administration would not impair the rights of bondholders and that he will veto any counter-proposal from the Legislature of Puerto Rico that would constitute a possible impairment of the rights of bondholders. On that same day, Standard & Poor's Ratings Service placed the Bonds on CreditWatch Negative and Fitch Ratings Ltd. placed the same Bonds on Rating Watch.

On March 14, 2008, a bill was submitted to the Legislature of Puerto Rico (B. of HR. 4273 and B. of S. 2419; collectively, the "Legislation") establishing the conditions for suspending the collection of portion of the Commonwealth Sales Tax for a reduction from 5.5% to 1% and re-instituting a revamped excise tax. The Legislation requires that such suspension cannot occur unless the Bonds are secured by a fully funded reserve fund (the "Reserve Fund") funded at an amount equal to the annual debt service obligation for the Bonds in the next ensuing bond year (the "Debt Service Reserve Requirement"), calculated in such manner as reasonably determined by COFINA to account for fixed and variable rate Bonds. The Reserve Fund is to be funded, and amounts in the Reserve Fund are to be maintained at the Debt Service Reserve Requirement, from deposits of collections of the Commonwealth Sales Tax, to the extent not required for the funding of COFINA operating expenses and debt service on Bonds, by the new excise tax, and by any other resources available to the Secretary of the Treasury. In the event that the Reserve Fund is not funded at least in the amount of the Debt Service Reserve Requirement for a period of thirty (30) days, COFINA shall notify the Secretary of the Treasury, and if the deficiency in the Reserve Fund is not funded from available resources within an additional thirty (30) days, the suspension of the collection of the 4.5% Commonwealth Sales Tax will be, without further legislative or administrative act, rescinded and collections thereof will resume, and the Secretary will no longer be authorized to collect the new excise tax. The Legislation has been structured to safeguard the rights of COFINA bondholders and is aimed at preserving the current rating of the Bonds. This action is expected to be revenue neutral for the General Fund. No assurance can be given that the above proposal will be enacted, or that if it is enacted, it will be in the form recommended by the Governor of Puerto Rico.

There are various pending legislations which, if approved, could have an impact on the Commonwealth Sales Tax.

### **Planning Board Revised Economic Growth Estimates**

On March, 2008, the Planning Board, as part of its final review of fiscal year 2007 economic statistics, indicated that it expected to reduce the 2007 economic growth rate to -1.8% from -1.4% and that the forecast for fiscal years 2008 and 2009 will be lowered on account of the projected length of the current recession. The factors that influenced the Board's fiscal year 2007 indication included higher oil prices, reductions in retail sales, private investment (especially in the construction sector) and government investment. Price increases in certain key areas such as energy and raw materials contributed to the Board's numbers as well.

### **Indictment of Governor of Puerto Rico**

On March 27, 2008, the Governor of Puerto Rico and several other individuals were named in federal grand jury indictments relating to the use of political contributions and campaign funds during the period when the Governor was Resident Commissioner in Washington, D.C. The Governor has denied any wrongdoing and has stated his intention to remain in his position and present his defense. It is not expected that such

developments will have any impact on the fiscal affairs of the Commonwealth or on the payment of any obligations issued by the Commonwealth.

## **TAX MATTERS**

### **Federal and Commonwealth Taxation of the Series 2008A Bonds—General**

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, under the provisions of the Acts of Congress now in force, and under existing statutes and court decisions, (a) interest on the Series 2008A Bonds is included in gross income for Federal income tax purposes under Section 103(a) of the United States Internal Revenue Code of 1986, as amended, except that no opinion is expressed with respect to certain Federal income tax matters covered by the opinion of Fiddler Gonzalez & Rodriguez, P.S.C., Special Tax Counsel to the Corporation, delivered to the Corporation on the date of delivery of the Series 2008A Bonds, and (b) the Series 2008A Bonds, and the interest thereon, are exempt from state, Commonwealth of Puerto Rico and local taxation.

### **Puerto Rico Tax Considerations (for Puerto Rico Residents only)**

The following is a summary of the opinion of Fiddler González & Rodríguez, P.S.C., Special Tax Counsel to the Corporation, regarding certain Puerto Rico tax consequences of the ownership of the Series 2008A Bonds by Puerto Rico residents. See also *Appendix D – Form of Opinion of Special Tax Counsel*. This section does not purport to cover all of the Puerto Rico tax consequences arising from the purchase and ownership of the Series 2008A Bonds. The following is based upon laws and regulations now in effect and is subject to change, and any change may apply retroactively and affect the accuracy of the opinions, statements and conclusions set forth in this discussion. You should consult your independent tax advisor as to the application to your particular situation of the tax discussion described below.

The discussion in connection with the Puerto Rico tax considerations is based on the current provisions of the Puerto Rico Internal Revenue Code of 1994, as amended (the “P.R. Code”), and the regulations promulgated or applicable thereunder (the “PR IRC Regulations”) issued by the Treasury Department of Puerto Rico (the “Treasury Department”); the Puerto Rico Municipal Property Tax Act of 1991, as amended (the “MPTA”), and the regulations promulgated thereunder; the Municipal License Tax Act, as amended (the “MLTA”), and the regulations promulgated thereunder; and certain industrial and incentive tax act described below. The U.S. federal tax discussion is based on the current provisions of the United States Internal Revenue Code of 1986, as amended (the “Code”) and the regulations promulgated thereunder (the “Code Regulations”).

This discussion deals only with Series 2008A Bonds held by original investors as capital assets within the meaning of Section 1121 of the P.R. Code and Section 1221 of the Code.

The existing provisions of the statutes, regulations, judicial decisions, and administrative pronouncements on which this summary is based, are subject to change (even with retroactive effect) and could affect the continued validity of this summary.

An opinion of counsel represents only such counsel’s best legal judgment and is not binding on the Treasury Department, any municipality or agency of Puerto Rico, the United States Internal Revenue Service or the courts. Accordingly, there can be no assurance that the opinions set forth herein, if challenged, would be sustained.

In the opinion of Fiddler González & Rodríguez, P.S.C., based on the laws of Puerto Rico now in force:

1. Interest on the Series 2008A Bonds is excluded from gross income and exempt from Puerto Rico income and withholdings taxes, including the alternative minimum tax imposed by Section 1017 of P.R. Code;



2. The Series 2008A Bonds are exempt from property taxes imposed by the MPTA, and interest thereon is exempt from the municipal license tax imposed by the MLTA;

3. The transfer of the Series 2008A Bonds by (i) gift will not be subject to gift tax under the P.R. Code in the case of donors who are residents of the Commonwealth at the time the gift is made and (ii) death will not be subject to estate tax under the P.R. Code in the case of a decedent who at the time of death was (x) a resident of Puerto Rico and (y) a United States citizen who acquired such citizenship solely by reason of birth or residence in Puerto Rico;

4. Gain recognized from the sale or exchange of a Series 2008A Bond will be subject to income tax under the P.R. Code to taxpayers subject to Puerto Rico income tax on such gains, including individuals residing in Puerto Rico and corporations and partnerships organized under the laws of the Commonwealth;

5. The Series 2008A Bonds will be considered an obligation of an instrumentality of Puerto Rico for purposes of (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the P.R. Code applicable to certain involuntary conversions and (ii) the exemption from the surtax imposed by Section 1102 of the P.R. Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of Puerto Rico and certain other investments; and

6. Interest on the Series 2008A Bonds constitutes “industrial development income” under Section 2(j) of the Puerto Rico Industrial Incentives Act of 1963, the Puerto Rico Industrial Incentives Act of 1978, the Puerto Rico Tax Incentives Act of 1987, and the Puerto Rico Tax Incentives Act of 1998, as amended (collectively, the “Acts”), when received by a holder of a grant of tax exemption issued under any of the Acts that acquired the Series 2008A Bonds with “eligible funds,” as such term is defined in the Acts.

The P.R. Code does not provide rules with respect to the treatment of the excess, if any, of the amount due at maturity of a Series 2008A Bond over its initial offering price (the “Accretion Amount”). Under the current administrative practice followed by the Puerto Rico Department of the Treasury, the Accretion Amount is treated as interest.

Prospective owners of the Series 2008A Bonds, including but not limited to financial institutions, should be aware that ownership of the Series 2008A Bonds may result in having a portion of their interest and other expenses attributable to interest on the Series 2008A Bonds disallowed as deductions for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

### **United States Federal Taxation for individual resident of Puerto Rico**

Disclosure pursuant to U. S. Internal Revenue Service Circular No. 230: This tax discussion is not intended or written to be used, and cannot be used by any taxpayer, for purposes of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service. This tax discussion was written in connection with the promotion or marketing of the Series 2008A Bonds. Each prospective purchaser of the Series 2008A Bonds should seek tax advice from an independent tax advisor based on its particular circumstances.

The following is a general discussion of the anticipated material federal income tax consequences of the purchase, ownership and disposition of the Series 2008A Bonds. This discussion does not address the tax consequences to persons other than initial purchasers who are Puerto Rico U.S. Holders (as defined below), and a Puerto Rico Corporation (as defined below) that hold their Series 2008A Bonds as capital assets within the meaning of Section 1221 of the Code and it does not address all of the tax consequences relevant to investors that are subject to special treatment under the United States federal income tax laws (such as life insurance companies, retirement plans, regulated investment companies, persons who hold transition bonds as part of a “straddle,” a “hedge” or a “conversion transaction,” persons that have a “functional currency” other than the U.S. dollar, investors in pass-through entities and tax-exempt organizations). This summary also does not address the consequences to holders of the Series 2008A Bonds under state, local or foreign tax laws.

This summary is based on current provisions of the Code, the Code Regulations, judicial decisions and published administrative rulings and pronouncements of the IRS and interpretations thereof.

As used herein, the term “Puerto Rico U.S. Holder” means a Puerto Rico individual that is an individual who is a citizen of the United States and a bona fide resident of Puerto Rico, within the meaning of Section 937 of the Code and the regulations thereunder, during the entire taxable year within, including the taxable year in which the Series 2008A Bonds are acquired by such individual. As used herein, the term “Puerto Rico Corporation” means a corporation organized under the laws of the Commonwealth of Puerto Rico.

**ALL PROSPECTIVE INVESTORS ARE ENCOURAGED TO CONSULT THEIR TAX ADVISERS REGARDING THE FEDERAL INCOME TAX CONSEQUENCES OF PURCHASING, OWNING AND DISPOSING OF THE SERIES 2008A BONDS IN LIGHT OF THEIR PARTICULAR CIRCUMSTANCES, AS WELL AS THE EFFECT OF ANY FOREIGN, STATE, LOCAL OR OTHER LAWS.**

#### *Interest on the Series 2008A Bonds*

Interest on the Series 2008A Bonds is not excludable from gross income for Federal income tax purposes under Section 103(a) of the Code. Payment of interest on the Series 2008A Bonds will generally be taxable to a U. S Holder as ordinary interest income at the time such payments are accrued or are received (in accordance with the U. S. Holder’s regular accounting method).

Interest on the Series 2008A Bonds received by, or “original issue discount” (within the meaning of the Code) accrued to, an individual who is a Puerto Rico U. S. Holders during the entire taxable year in which such interest is received or “original issue discount” is accrued will constitute gross income from sources within Puerto Rico and, therefore, is excludable from gross income for purposes of the Code pursuant to section 933(1) thereof.

Interest on the Series 2008A Bonds received by, or “original issue discount” (within the meaning of the Code) accrued to, a Puerto Rico Corporation, is not subject to income taxation under the Code provided such interest or “original issue discount” is not effectively connected, or treated as effectively connected, with or attributable to the conduct of a trade or business within the United States by such corporation.

#### *Sale or Retirement of the Series 2008A Bonds*

In general, pursuant to the provisions of Section 1.937-of the Code Regulations, the source of the income from the disposition of personal property by a Puerto Rico U.S. Holder shall be determined under the rules of Section 865 of the Code. Accordingly, the gain on the sale or exchange of the Series 2008A Bonds (excluding “original issue discount” under the Code as of the date of the sale or exchange), recognized by a Puerto Rico U.S. Holder will constitute Puerto Rico source income and, therefore, qualify for the income exclusion under in Section 933(1) of the Code.

A Puerto Rico Corporation generally will not be subject to income or withholding tax under the Code on a gain realized on the sale or exchange of Series 2008A Bonds, unless the gain is effectively connected with the conduct by the Puerto Rico Corporation of a trade or business in the United States and other requirements are satisfied.

#### *Backup Withholding*

Backup withholding of United States federal income tax may apply to payments made in respect of the Series 2008A Bonds to registered owners who are not “exempt recipients” and who fail to provide certain identifying information (such as the registered owner’s taxpayer identification number) in the required manner. Generally, individuals are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients. Payments made in respect of the Series 2008A Bonds to a Puerto Rico U.S. Holder must be reported to the IRS, unless the Puerto Rico U.S. Holder is an exempt recipient or establishes an exemption. A

Puerto Rico U.S. Holder can obtain a complete exemption from the backup withholding tax by filing Form W-9 (Payer's Request for Taxpayer Identification Number and Certification).

Any amounts withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or a credit against such beneficial owner's United States federal income tax provided the required information is furnished to the IRS.

Prospective owners of the Series 2008A Bonds should also be aware that the Code provides special rules for the taxation of shareholders of foreign corporations that qualify as "controlled foreign corporations," "personal holding companies," "foreign personal holding companies" or "passive foreign investment companies," as such terms are defined by the Code.

The opinion of the Special Tax Counsel regarding the tax consequences under Puerto Rico law and the Code arising from ownership of, receipt or accrual of interest on, or disposition of the Series 2008A Bonds is limited to the above. We express no opinion as to the laws of jurisdictions other than Puerto Rico and the United States federal laws applicable to Puerto Rico, or to any other laws of any other jurisdiction or compliance therewith by any party.

### **United States Tax Considerations**

The following discussion is a summary of the principal Federal income tax consequences of the acquisition, ownership and disposition of the Series 2008A Bonds by original purchasers of the Series 2008A Bonds. This summary is based on the Code, Treasury regulations, revenue rulings and court decisions, all as now in effect and all subject to change at any time, possibly with retroactive effect. This summary assumes that the Series 2008A Bonds will be held as "capital assets" under the Code, and it does not discuss all of the Federal income tax consequences that may be relevant to a holder in light of its particular circumstances or to holders subject to special rules, such as insurance companies, financial institutions, tax-exempt organizations, dealers in securities or foreign currencies, persons holding the Series 2008A Bonds as a position in a "hedge" or "straddle" for Federal income tax purposes, or holders whose functional currency (as defined in Section 985 of the Code) is not the United States dollar. Each prospective purchaser of the Series 2008A Bonds should consult with its own tax advisor concerning the Federal income tax and other tax consequences to it of the acquisition, ownership and disposition of the Series 2008A Bonds as well as any tax consequences that may arise under the laws of any state, local or foreign tax jurisdiction.

For the proposed form of approving opinion of Bond Counsel to the Corporation, see *Appendix C* hereto.

- As used herein, the term "U.S. Holder" means a beneficial owner of a Series 2008A Bond that is for Federal income tax purposes (i) a citizen or resident of the United States, other than individuals who are bona fide residents of Puerto Rico during the entire taxable year, (ii) a corporation, partnership or other entity created or organized in the United State or under the laws of the United States , (iii) an estate the income of which is subject to Federal income taxation regardless of its source, or (iv) a trust whose administration is subject to the primary jurisdiction of a United States court and which has one or more United States fiduciaries who have the authority to control all substantial decisions of the trust, or a trust that was in existence on August 20, 1996 and validly elected to be treated as a domestic trust. As used herein, the term "Non-U.S. Holder" means a beneficial owner of a Series 2008A Bond that is not a U.S. Holder other than a Puerto Rico U.S. Holder.

## U.S. Holders of the Series 2008A Bonds

### *U.S. Holders—Interest Income*

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, under the provisions of the Acts of Congress now in force, and under existing statutes and court decisions, (a) interest on the Series 2008A Bonds is included in gross income for Federal income tax purposes, except that no opinion is expressed with respect to certain federal income tax matters covered by the opinion of Fiddler, González & Rodríguez, P.S.C., Special Tax Counsel to the Corporation, delivered to the Corporation on the date of delivery of the Series 2008A Bonds, and (b) the Series 2008A Bonds, and the interest thereon, are exempt from state, Commonwealth of Puerto Rico and local taxation. Bond Counsel to the Corporation expresses no opinion regarding any other Federal, state, Commonwealth or local tax consequences with respect to the Series 2008A Bonds.

### *U.S. Holders—Original Issue Discount*

*Original Issue Discount.* The following summary is a general discussion of the U.S. federal income tax consequences to U.S. Holders of the purchase, ownership and disposition of the Series 2008A Bonds issued with original issued discount. The following summary is based upon final Treasury Regulations (the “OID Regulations”) released by the Internal Revenue Service under the OID provisions of the Code.

For Federal income tax purposes, a Series 2008A Bond will be treated as issued with original issue discount (“OID”) if the excess of a Series 2008A Bond’s “stated redemption price at maturity” over its “issue price” equals or exceeds a statutorily determined *de minimis* amount. The “issue price” of each Series 2008A Bond in a particular issue equals the first price at which a substantial amount of such issue is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The “stated redemption price at maturity” of a Series 2008A Bond is the sum of all payments provided by such Series 2008A Bond other than “qualified stated interest” payments. The term “qualified stated interest” generally means stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) at least annually at a single fixed rate. In general, if the excess of a Series 2008A Bond’s stated redemption price at maturity over its issue price is less than .25 percent of the Series 2008A Bond’s stated redemption price at maturity multiplied by the number of complete years to its maturity (the “*de minimis* amount”), then such excess, if any, constitutes *de minimis* OID, and the Series 2008A Bond is not treated as being issued with OID and all payments of stated interest (including stated interest that would otherwise be characterized as OID) is treated as qualified stated interest, as described below. However, under the OID Regulations, if a Series 2008A Bond bears interest for one or more accrual periods at a rate below the rate applicable for the remaining term of such Series 2008A Bond (*e.g.*, Series 2008A Bonds with teaser rates or interest holidays), and if the greater of either the resulting foregone interest on such Series 2008A Bond or any “true” discount on such Series 2008A Bond (*i.e.*, the excess of the Series 2008A Bond’s stated principal amount over its issue price) equals or exceeds a specified *de minimis* amount, then the stated interest on the Series 2008A Bond would be treated as OID rather than qualified stated interest.

Payments of qualified stated interest on a Series 2008A Bond are taxable to a U.S. Holder as ordinary interest income at the time such payments are accrued or are received in accordance with the U.S. Holder’s regular method of tax accounting. A U.S. Holder of a Series 2008A Bond having a maturity of more than one year from its date of issue generally must include OID in income as ordinary interest as it accrues on a constant-yield method in advance of receipt of the cash payments attributable to such income, regardless of such U.S. Holder’s regular method of tax accounting. The amount of OID included in income by the U.S. Holder of a Series 2008A Bond is the sum of the daily portions of OID with respect to such Series 2008A Bond for each day during the taxable year (or portion of the taxable year) on which such U.S. Holder held such Series 2008A Bond.

The daily portion of OID on any Series 2008A Bond is determined by allocating to each day in any “accrual period” a ratable portion of the OID allocable to the accrual period. All accrual periods with respect to a Series 2008A Bond may be of any length and the accrual periods may vary in length over the term of the Series 2008A Bond, provided that each accrual period is no longer than one year and each scheduled payment of principal or interest occurs either on the first or final day of an accrual period. The amount of OID allocable to an accrual period is generally equal to the difference between (i) the product of the Series 2008A Bond’s “adjusted issue price” at the beginning of such accrual period and such Series 2008A Bond’s yield to maturity (determined on the basis of compounding at the close of each accrual period and appropriately adjusted to take into account the length of the particular accrual period) and (ii) the amount of any qualified stated interest payments allocable to such accrual period. The “adjusted issue price” of a Series 2008A Bond at the beginning of any accrual period is the issue price of the Series 2008A Bond plus the amount of accrued OID includable in income for all prior accrual periods minus the amount of any prior payments on the Series 2008A Bond other than qualified stated interest payments. The amount of OID allocable to an initial short accrual period may be computed using any reasonable method if all other accrual periods other than a final short accrual period are of equal length. The amount of OID allocable to the final accrual period is the difference between (i) the amount payable at the maturity of the Series 2008A Bond (other than a payment of qualified stated interest) and (ii) the Series 2008A Bond’s adjusted issue price as of the beginning of the final accrual period. Under the OID rules, U.S. Holders generally will have to include in income increasingly greater amounts of OID in successive accrual periods.

A U.S. Holder may elect to include in gross income all interest that accrues on a Series 2008A Bond using the constant-yield method described above under the heading “U.S. Holders—Original Issue Discount,” with the modifications described below. For purposes of this election, interest includes, among other things, stated interest, OID and de minimis OID, as adjusted by any amortizable bond premium described below under the heading “U.S. Holders—Bond Premium.” In applying the constant-yield method to a Series 2008A Bond with respect to which this election has been made, the issue price of the Series 2008A Bond will equal its cost to the electing U.S. Holder, the issue date of the Series 2008A Bond will be the date of its acquisition by the electing U.S. Holder, and no payments on the Series 2008A Bond will be treated as payments of qualified stated interest. The election will generally apply only to the Series 2008A Bond with respect to which it is made and may not be revoked without the consent of the Internal Revenue Service. If this election is made with respect to a Series 2008A Bond with amortizable bond premium, then the electing U.S. Holder will be deemed to have elected to apply amortizable bond premium against interest with respect to all debt instruments with amortizable bond premium (other than debt instruments the interest on which is excludable from gross income) held by the electing U.S. Holder as of the beginning of the taxable year in which the Series 2008A Bond with respect to which the election is made is acquired or thereafter acquired. The deemed election with respect to amortizable bond premium may not be revoked without the consent of the IRS.

The Series 2008A Bonds may be redeemed at the option of the Corporation prior to their stated maturity. The Series 2008A Bonds containing such features may be subject to rules that differ from the general rules discussed above. Investors intending to purchase Series 2008A Bonds with such features should consult their own tax advisors, since the original issued discount consequences will depend, in part, on the particular terms and features of the purchased Series 2008A Bonds.

U.S. Holders of any Series 2008A Bonds issued with OID should consult their own tax advisors with respect to the treatment of OID for Federal income tax purposes, including various special rules relating thereto, and tax consequences under tax laws of the states, including their political subdivisions, and the District of Columbia, in connection with the acquisition, ownership, and disposition of Series 2008A Bonds.

#### *U.S. Holders—Bond Premium*

In general, if a U.S. Holder acquires a Series 2008A Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on the Series 2008A Bond after the acquisition date (excluding certain “qualified stated interest” that is unconditionally payable at least annually at prescribed rates), that premium constitutes “bond premium” on that Series 2008A

Bond (a “Premium Bond”). In general, under Section 171 of the Code, a U.S. Holder of a Premium Bond may either deduct the amortizable bond premium for a taxable year under Section 171(a)(1) of the Code or may elect to amortize the total bond premium over the remaining term of the Premium Bond, based on the U.S. Holder’s yield over the remaining term of the Premium Bond, following constant yield principles. (In certain cases involving a Premium Bond callable prior to its stated maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the highest yield on such bond.) Any such election applies to all debt instruments of the U.S. Holder (other than tax-exempt bonds) held at the beginning of the first taxable year to which the election applies and to all such debt instruments thereafter acquired, and is irrevocable without the Internal Revenue Service’s consent. A U.S. Holder of a Premium Bond that so elects to amortize bond premium does so by offsetting the qualified stated interest allocable to each interest accrual period under the U.S. Holder’s regular method of Federal tax accounting against the bond premium allocable to that period. If the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is treated as a bond premium deduction under Section 171(a)(1) of the Code, subject to certain limitations. If a Premium Bond is optionally callable before maturity at a price in excess of its stated redemption price at maturity, special rules may apply with respect to the amortization of bond premium. Under certain circumstances, the U.S. Holder of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the U.S. Holder’s original acquisition cost.

U.S. Holders of any Premium Bonds should consult their own tax advisors with respect to the treatment of bond premium for Federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, and disposition of Premium Bonds.

#### *U.S. Holders—Disposition of Series 2008A Bonds*

Except as discussed above, upon the sale, exchange, redemption, or other disposition (which would include a legal defeasance) of a Series 2008A Bond, a U.S. Holder generally will recognize taxable gain or loss in an amount equal to the difference between the amount realized (other than amounts attributable to accrued interest not previously includable in income) and such U.S. Holder’s adjusted tax basis in the Series 2008A Bond. A U.S. Holder’s adjusted tax basis in a Series 2008A Bond generally will equal such U.S. Holder’s initial investment in the Series 2008A Bond, increased by any OID included in the U.S. Holder’s income with respect to the Series 2008A Bond and decreased by the amount of any payments, other than qualified stated interest payments, received and bond premium amortized with respect to such Series 2008A Bond. Such gain or loss generally will be long-term capital gain or loss if the Series 2008A Bond was held for more than one year.

#### *U.S. Holders—Defeasance*

U.S. Holders of the Series 2008A Bonds should be aware that, for Federal income tax purposes, the deposit of moneys or securities in escrow in such amount and manner as to cause the Series 2008A Bonds to be deemed to be no longer outstanding under the resolution of the Series 2008A Bonds (a “defeasance”), could result in a deemed exchange under Section 1001 of the Code and a recognition by such owner of taxable income or loss, without any corresponding receipt of moneys. In addition, for Federal income tax purposes, the character and timing of receipt of payments on the Series 2008A Bonds subsequent to any such defeasance could also be affected. U.S. Holders of the Series 2008A Bonds are advised to consult with their own tax advisors regarding the consequences of a defeasance for Federal income tax purposes and under the tax laws of the states, including their political subdivisions, and the District of Columbia.

#### **Non-U.S. Holders of the Series 2008A Bonds**

Under existing Federal income tax law, interest (including any OID) on the Series 2008A Bonds is considered to be income from sources without the United States, and unless effectively connected with the conduct of a United States trade or business of a Non-U.S. Holder, such interest is not subject to Federal income or withholding tax when paid to or for a Non-U.S. Holder. A Non-U.S. Holder may be requested to furnish its

name and address and to certify under penalties of perjury, using IRS Form W-8 or substantially similar substitute form, that it is not a United States person and is the beneficial owner of a Series 2008A Bond.

In general, a Non-U.S. Holder of a Series 2008A Bond is not subject to Federal income or withholding tax, under existing law, with respect to any gain realized on the sale, exchange, retirement or other disposition of a such a bond, unless the Non-U.S. Holder is an individual who is present in the United States for 183 days or more during the taxable year and certain other requirements are met, or unless the gain is effectively connected with the conduct of a United States trade or business of the Non-U.S. Holder.

Any person who seeks to become a Non-U.S. Holder of a Series 2008A Bond is advised to consult with its own tax advisor concerning the foregoing or any other Federal income tax consequences that may arise in connection with the acquisition, ownership and disposition of such a bond.

## **Information Reporting and Backup Withholding for the Series 2008A Bonds**

### *U.S. Holders*

In general, information reporting requirements will apply to non-corporate U.S. Holders with respect to payments of principal, payments of interest, and the accrual of OID on a Series 2008A Bond and the proceeds of the sale of a Series 2008A Bond before maturity within the United States. Backup withholding may apply to U.S. Holders under Section 3406 of the Code to such payments and to payments of OID unless the U.S. Holder (i) is a corporation or other exempt recipient and, when required, demonstrates that fact, or (ii) provides a correct taxpayer identification number, certifies under penalties of perjury, when required, that such U.S. Holder is not subject to backup withholding and has not been notified by the IRS that it has failed to report all interest and dividends required to be shown on its Federal income tax returns.

In addition, upon the sale of a Series 2008A Bond to (or through) a broker, the broker must report the sale and withhold on the entire purchase price, unless either (i) the broker determines that the seller is a corporation or other exempt recipient or (ii) the seller certifies that such seller is a non-U.S. Holder (and certain other conditions are met). Certification of the registered owner's non-U.S. status would be made normally on an IRS Form W-8BEN under penalties of perjury, although in certain cases it may be possible to submit other documentary evidence.

Any amounts withheld under the backup withholding rules from a payment to a beneficial owner, and which constitutes over-withholding, would be allowed as a refund or a credit against such beneficial owner's Federal income tax provided the required information is furnished to the IRS.

### *Non-U.S. Holders*

Under existing Federal income tax law, information reporting and backup withholding do not apply to payments of principal and interest (including OID) made to a Non-U.S. Holder in respect of a Series 2008A Bond, provided that the payor does not have actual knowledge that such Bondholder is a United States person.

## **IRS Circular 230 Disclosure**

The advice under the captions "United States Tax Considerations Relating," "U.S. Holders of the Series 2008A Bonds," and "Non-U.S. Holders of the Series 2008A Bonds," concerning certain income tax consequences of the acquisition, ownership and disposition of the Series 2008A Bonds, was written to support the marketing of the Series 2008A Bonds. To ensure compliance with requirements imposed by the IRS, Bond Counsel to the Corporation informs you that (i) any Federal tax advice contained in the Official Statement (including any attachments) or in writings furnished by the Bond Counsel to the Corporation is not intended to be used, and cannot be used by any Bondholder, for the purpose of avoiding penalties that may be imposed on

the Bondholder under the Code, and (ii) the Bondholder should seek advice from an independent tax advisor based on the Bondholder's particular circumstances.

## **RATINGS**

It is a condition to the issuance of the Series 2008A Bonds that they have received ratings of "A1" from Moody's and "A+" with a negative credit watch from S&P. These ratings only reflect the respective opinions of such rating agencies. Any explanation of the significance of such ratings must be obtained from the respective rating agency. There is no assurance that any such rating will continue in effect for any period or that any such rating will not be revised or withdrawn entirely by either such rating agency if, in its judgment, circumstances so warrant. Any such downgrade revision or withdrawal of such rating or ratings may have an adverse effect on the market prices of the Series 2008A Bonds. A securities rating is not a recommendation to buy, sell, or hold securities. Each security rating should be evaluated independently of any other security rating.

## **LEGALITY FOR INVESTMENT**

The Series 2008A Bonds will be eligible for deposit by banks in the Commonwealth to secure public funds and will be approved investments for insurance companies to qualify them to do business in the Commonwealth, as required by law.

## **DISTRIBUTION**

UBS Financial Services Incorporated of Puerto Rico will act as Principal in a riskless principal transaction and will purchase the Bonds from the Corporation subject to the terms and conditions of an Agency Agreement by and between the Corporation and the Principal. In turn, the Purchasers (as such term is defined in the Bond Purchase Agreement between the Corporation, the Principal and the purchasers named therein) shall purchase the Bonds from the Principal. Notwithstanding the foregoing, the Principal shall not be obligated to purchase the Bonds on the date of delivery thereof unless it has received from Purchasers the purchase price of the Bonds. The Corporation will pay the Principal a fee in an amount equal to \$2,948,187.97.

## **LEGAL MATTERS**

All legal matters incident to the authorization, issuance, sale and delivery of the Series 2008A Bonds are subject to the approval of Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel to the Corporation. The issuance of the Series 2008A Bonds is conditioned upon the delivery on the date of issuance of the approving opinion of Bond Counsel to the Corporation substantially in the form attached to this Official Statement as *Appendix C* and the opinion of Fiddler González & Rodríguez, P.S.C. as Special Tax Counsel substantially in the form attached to this Official Statement as *Appendix D*. Certain legal matters will be passed for the Principal by their counsel, Fiddler González & Rodríguez, P.S.C., San Juan, Puerto Rico.

## **CONTINUING DISCLOSURE**

In order to assist the Principal in complying with Rule 15c2-12, as amended (the "Rule"), promulgated by the SEC under the Exchange Act, the Corporation and the Trustee entered into a certain Master Continuing Disclosure Agreements, dated as of July 31, 2007 (the "Disclosure Agreement") for the benefit of the owners of the Bonds, including the Series 2008A Bonds, to provide continuing disclosure. The Corporation will undertake for the benefit of the owners of the Bonds to provide to each Nationally Recognized Municipal Securities Information Repository ("NRMSIR" and each a "Repository") or with the Municipal Securities Rulemaking Board ("MSRB"), and, if and when one is established, the Commonwealth Information Depository, on an annual basis within 305 days after the end of each Fiscal Year, commencing with the Fiscal Year ending June 30, 2008, the Annual Information as described in more detail below.



The “Annual Information” shall consist of (a) the information regarding actual receipts of the Pledged Sales Tax received by the Corporation from the paying/receiving agent, (b) the annual audited financial statements of the Corporation, and together with (c) such narrative explanation as may be necessary to avoid misunderstanding and to assist the reader in understanding the presentation of such information.

The Corporation will further agree to file, in a timely manner, with each Repository or with the MSRB, and with the Commonwealth Information Depository, if any, notice of any of the following events with respect to the Bonds, if, in the judgment of the Corporation or its agent, such event is material: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the tax-exempt status of the Bonds; (7) modifications to the rights of the security owners (including Beneficial Owners) of the Bonds; (8) bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds; and (11) rating changes. In addition, the Corporation will undertake, for the benefit of the owners of the Bonds, to provide to each such Repository or the MSRB, and to the Commonwealth Information Depository, if any, in a timely manner, notice of any failure by the Corporation to provide the Annual Information by the date required in the Corporation’s undertaking described above.

Events (4) and (5) above are included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. With respect to the following events:

Event (4) and (5). The Corporation does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the Bonds, unless the Corporation applies for or participates in obtaining the enhancement.

Event (6). For information on the tax status of the Bonds, see “TAX MATTERS.”

Event (8). The Corporation does not undertake to provide notice of a mandatory scheduled redemption not otherwise contingent upon the occurrence of an event if (i) the terms, dates and amounts of redemption are set forth in detail in this Official Statement under “*Redemption*” under “THE SERIES 2008A BONDS” above, (ii) the only open issue is which Bonds will be redeemed in the case of a partial redemption, (iii) notice of redemption is given to the Bondowners as required under the terms of the Bonds, (iv) public notice of the redemption is given pursuant to the Exchange Act Release Number 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or bond purchases.

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

On September 7, 2004, the Commission released an interpretive letter (the “Letter”) approving the use of [www.DisclosureUSA.org](http://www.DisclosureUSA.org) (“DisclosureUSA”), created by the Municipal Advisory Council of Texas (“Texas MAC”), as a means by which continuing disclosure filings may be made under the Rule, subject to certain qualifications set forth in the Letter. The Corporation may choose to satisfy its obligations to file the information required by the Rule with the repositories by transmitting such filings (the “Filings”), either directly or indirectly through a designated agent, to DisclosureUSA for submission to each NRMSIR and Commonwealth Information Depository (without also separately submitting the Filings to the NRMSIRs and Commonwealth Information Depository by some other means). The Corporation intends to monitor the performance of Texas MAC with regard to the submission of the Filings to the NRMSIRs and Commonwealth Information Depository. In the event that Texas MAC fails, with respect to the Filings, to perform the functions or undertake the responsibilities referenced in the Letter, or if for any reason the SEC modifies or revokes its interpretation described in the Letter, such that transmission of the Filings to DisclosureUSA would no longer satisfy the

Corporation's obligation under the Disclosure Agreement, the Corporation will separately submit the Filings to the NRMSIRs and Commonwealth Information Depository.

As of the date of this Official Statement, there is no Commonwealth Information Depository, and the nationally recognized municipal securities information repositories are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's Securities Evaluations, Inc., 55 Water Street, 45th Floor, New York, New York 10041; Interactive Data Pricing and Reference Data, Inc., Attn: NRMSIR, 100 William Street, 15<sup>th</sup> Floor, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Corporation acknowledges that its undertakings pursuant to the Rule described above are intended to be for the benefit of the Beneficial Owners of the Bonds, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of the Corporation's obligations hereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the Corporation written notice of any request to cure such breach, and the Corporation shall have refused to comply within a reasonable time. All Proceedings shall be instituted only as specified in the Disclosure Agreement in any Commonwealth court located in the Municipality of San Juan, Puerto Rico, for the equal benefit of all beneficial owners of the outstanding Bonds benefited by the Covenants, and no remedy shall be sought or granted other than specific performance of the Covenant at issue.

The Covenants may only be amended if:

(1) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Corporation, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the Bonds, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interests of Beneficial Owners, as determined by parties unaffiliated with the Corporation; 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 Corporation 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 Covenants have been made in order to assist the Principal to comply with the Rule.

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

As provided by Act No. 272 of the Legislature of the Commonwealth, approved May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the Corporation in connection with the Series 2008A Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Principal of the Series 2008A Bonds. The Principal has been selected by Government Development Bank to serve from time to time as underwriter of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. The Principal or its affiliates participate in other financial transactions with Government Development Bank. Government Development Bank is an intended recipient of the payment or retirement of Extraconstitutional Debt with the proceeds of the Series 2008A Bonds.

## MISCELLANEOUS

The summaries and explanations of the Resolution, the various acts, the Series 2008A Bonds and the other financing documents contained herein do not purport to be complete statements of any or all of the provisions of such documents and are made subject to all the detailed provisions thereof, to which reference is hereby made for further information. Copies of the foregoing documents are available from the Corporation, upon written request directed to: Puerto Rico Sales Tax Financing Corporation, c/o Government Development Bank for Puerto Rico, Roberto Sánchez Vilella Government Center, De Diego Avenue, Stop 22, Santurce, Puerto Rico 00940, Attention: President.

The Corporation has engaged Mesirow Financial, Inc., Chicago, Illinois, as Financial Advisor (the “Financial Advisor”) in connection with the Corporation’s issuance and sale of the Series 2008A Bonds. Under the terms of the engagement, the Financial Advisor is not obligated to undertake any independent verification of or assume any responsibility for the accuracy, completeness, or fairness of the information contained in this Official Statement.

Appended to and constituting a part of this Official Statement is certain economic information relating to the Commonwealth and the sales of goods in the Commonwealth (*Appendix A*), the summary of certain definitions and provisions of the Resolution (*Appendix B*), the proposed form of approving opinion of Bond Counsel (*Appendix C*), the proposed form of tax opinion of Special Tax Counsel (*Appendix D*), the summary of the book-entry system for the Series 2008A Bonds (*Appendix E*), and the table of Compounded Amounts for the Capital Appreciation Bonds (*Appendix F*).

The information included in this Official Statement or incorporated herein by reference, except for information pertaining to DTC, was supplied by certain officials of the Corporation or certain Commonwealth 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 obtained from materials published by DTC.

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

### **PUERTO RICO SALES TAX FINANCING CORPORATION**

By: \_\_\_\_\_ /s/ Samuel Sierra Rivera  
Executive Director

**COMMONWEALTH OF PUERTO RICO  
ECONOMIC INFORMATION**

**INTRODUCTION**

**Geographic Location and Demography**

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

According to the United States Census Bureau, the population of Puerto Rico was 3,808,610 in 2000 (3,927,776 as of July 1, 2006 according to a Census Bureau estimate), compared to 3,522,000 in 1990. As of 2000, the population of San Juan, the island's capital and largest city, was 434,375.

**Relationship with the United States**

Puerto Rico was discovered by Columbus in 1493 and shortly thereafter the island was conquered and settled by the Spaniards. It remained a Spanish possession for four centuries.

Puerto Rico came under United States sovereignty pursuant to the Treaty of Paris, signed on December 10, 1898, which ended the Spanish-American War. Puerto Ricans have been citizens of the United States since 1917. In 1950, after a long evolution toward greater self-government for Puerto Rico, the Congress of the United States enacted Public Law 600, which is "in the nature of a compact" and which became effective upon its acceptance by the electorate of Puerto Rico. It provides that those sections of existing law which defined the political, economic, and fiscal relationship between Puerto Rico and the United States would remain in full force. It also authorized the people of Puerto Rico to draft and adopt their own Constitution. The Constitution was drafted by a popularly elected constitutional convention, overwhelmingly approved in a special referendum by the people of Puerto Rico and approved by the United States Congress and the President of the United States, becoming effective upon proclamation of the Governor of Puerto Rico on July 25, 1952. Puerto Rico's relationship with the United States is referred to herein as commonwealth status.

The United States and the Commonwealth of Puerto Rico (the "Commonwealth") share a common defense, market, and currency. The Commonwealth exercises virtually the same control over its internal affairs as do the 50 states. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner 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.

**Governmental Structure**

The Constitution of the Commonwealth provides for the separation of powers of the executive, legislative, and judicial branches of government. The Governor is elected every four years. The Legislative Assembly consists of a Senate and a House of Representatives, the members of which are elected for four-year terms. The highest court within the local jurisdiction is the Supreme Court of Puerto Rico. Puerto Rico constitutes a District in the federal judiciary and has its own United States District Court. Decisions of this

court may be appealed to the United States Court of Appeals for the First Circuit and from there to the Supreme Court of the United States.

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

### **Principal Officials Responsible for Fiscal Matters**

Aníbal Acevedo Vilá was sworn in as Governor of Puerto Rico on January 2, 2005. He is a graduate of the University of Puerto Rico, where he obtained a Bachelor's degree in Political Science and a Juris Doctor degree. He obtained an LL.M. from Harvard Law School and served as law clerk for Puerto Rico Supreme Court Judge Federico Hernández Denton and for U.S. First Circuit Court of Appeals Judge Levin Campbell. He also served in the public sector as legislative adviser to the Governor of Puerto Rico. From 1993 to 2001, he served as an elected member of the Puerto Rico House of Representatives. From 2001 until assuming his position as Governor, he served as the elected Resident Commissioner of the Commonwealth in the U.S. House of Representatives.

Angel Ortíz García was named acting Secretary of the Department of the Treasury (the "Treasury") in May 30, 2008. He is a certified public accountant and a lawyer. He graduated from the University of Puerto Rico, where he obtained a Bachelor's degree in Accounting and a Juris Doctor degree. Between March and May, 2008 Mr. Ortiz was Assistant Secretary of Internal Revenue. Previously, since April 2005, he was Assistant Secretary of the Treasury Division. Prior to working in the Government, between May 2001 and April 2005, Mr. Ortiz was Senior Treasurer of Pfizer Pharmaceuticals LLC. Prior to 2001, he worked at PricewaterhouseCoopers.

Armando A. Valdez was appointed Executive Director of the Commonwealth of Puerto Rico Office and Management and Budget in January 2008. Before that, he served as advisor to the Governor from January 2005 to December 2007, as Executive Director of the Incoming Transition Committee from November 2004 to December 2004, and as Director of Intergovernmental Affairs to the Puerto Rico Federal Affairs Administration from June 2001 to December 2003. He earned a Bachelor of Arts degree in Architecture from Yale University and a Masters degree in Government (thesis pending) from John Hopkins University.

Jorge Irizarry Herráns was appointed President of Government Development Bank for Puerto Rico ("GDB") on December 4, 2007. Mr. Irizarry served as Executive Vice President and Director of Financing of GDB from 2005 until his appointment as Acting President, and has over 30 years of experience in banking, investments and consulting, which he acquired while working at Chase Manhattan, Booz Allen Hamilton, Inc., Banco Mercantil, Banco de Ponce, PaineWebber, Inc. and Sandoval Associates. Mr. Irizarry has Bachelor's degree in finance from New York University and holds a Masters Degree in Business Administration from Harvard Business School.

### **Political Trends**

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

	<u>1988</u>	<u>1992</u>	<u>1996</u>	<u>2000</u>	<u>2004</u>
Popular Democratic Party	48.7%	45.9%	44.5%	48.6%	48.4%
New Progressive Party	45.8%	49.9%	51.1%	45.7%	48.2%
Puerto Rico Independence Party	5.4%	4.2%	3.8%	5.2%	2.7%
Others	0.1%	-	0.6%	0.5%	0.6%

With the results of the 2004 election, control of the executive branch continued under the Popular Democratic Party while the legislative branch is now controlled by the New Progressive Party. The composition of the Senate and House of Representatives by political party is as follows:

	<u>Senate</u>	<u>House</u>
Popular Democratic Party	9	18
New Progressive Party	17	32
Puerto Rico Independence Party	1	1
Total	<u>27</u>	<u>51</u>

The next general election (gubernatorial, municipal, and legislative) in Puerto Rico will be held in November 2008. Voter participation in Puerto Rico is substantially higher than in the United States, averaging 82% since 1972.

## COMMONWEALTH SALES TAX

### Factors Affecting Sales Tax Revenues

The economic indicators which correlate most closely with the level of sales of goods and services in the Commonwealth are Gross National Product (“GNP”), personal consumption and personal income. These factors, in turn, are affected by other variables such as: the price of oil, employment rates, among others. These factors are the indicators utilized by the Commonwealth to make projections of Commonwealth Sales Tax revenues.

The following table shows the Commonwealth Sales Tax actual collections from November 15, 2006 to June 30, 2007, and the ten month-period of fiscal year 2007-2008.

### Commonwealth Sales Tax Collections (in millions)

<u>2006-07</u>	<u>July</u>	<u>Aug.</u>	<u>Sept.</u>	<u>Oct.</u>	<u>Nov.</u>	<u>Dec.</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>	<u>Apr.</u>	<u>May</u>	<u>June</u>	<u>Total</u>
<b>F.I.A</b>	-	-	-	-	\$ 9.1	\$ 20.0	\$17.3	\$15.7	\$17.5	\$15.6	\$17.0	\$17.5	\$129.7
<b>CINE<sup>(1)</sup></b>	-	-	-	-	-	-	-	-	-	-	-	1.1	1.1
<b>G.F.</b>	-	-	-	-	<u>41.1</u>	<u>90.0</u>	<u>77.7</u>	<u>70.5</u>	<u>78.9</u>	<u>70.1</u>	<u>77.4</u>	<u>76.8</u>	<u>582.5</u>
<b>Total</b>	-	-	-	-	<u>\$50.2</u>	<u>\$110.0</u>	<u>\$95.0</u>	<u>\$86.2</u>	<u>\$96.4</u>	<u>\$85.7</u>	<u>\$94.4</u>	<u>\$95.4</u>	<u>\$713.3</u>
<u>2007-08</u>	<u>July</u>	<u>Aug.</u>	<u>Sept.</u>	<u>Oct.</u>	<u>Nov.</u>	<u>Dec.</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>	<u>Apr.</u>	<u>May</u>	<u>June</u>	<u>Total</u>
<b>F.I.A</b>	\$96.1	\$88.9	-	-	-	-	-	-	-	-	-	-	\$185.0
<b>CINE<sup>(1)</sup></b>	-	-	\$ .8	\$ .2	\$ .2	\$ .2	\$ .2	\$ .2	\$ .2	\$ .2	-	-	\$2.7
<b>G.F.</b>	-	<u>1.2</u>	<u>85.3</u>	<u>93.4</u>	<u>95.9</u>	<u>120.9</u>	<u>89.5</u>	<u>86.2</u>	<u>89.0</u>	<u>93.2</u>	-	-	<u>755.0</u>
<b>Total<sup>(2)</sup></b>	<u>\$95.1</u>	<u>\$90.1</u>	<u>\$86.1</u>	<u>\$93.7</u>	<u>\$96.1</u>	<u>\$121.2</u>	<u>\$89.7</u>	<u>\$86.4</u>	<u>\$89.3</u>	<u>\$93.4</u>	-	-	<u>\$942.7</u>

(1) Pursuant to Act No. 23 of March 8, 2007, the Secretary of the Treasury must transfer said moneys to the Fund for the Development of the Arts, Sciences, and Cinematographic Industry of Puerto Rico.

(2) Preliminary.

As of today, twenty-nine percent of the collections from the Commonwealth Sales Tax are received electronically.

## THE ECONOMY

The information below provides certain general economic data about the Commonwealth, particularly data relating to those indicators of economic activity which may correlate most closely with the level of consumption of goods and services on the Commonwealth and, thus, the level of Commonwealth Sales Tax revenues. This summary does not purport to discuss all of the variables which may impact the level of Commonwealth Sales Tax revenues. The data in this section is provided as a general indication of prior levels of consumption and of the economic activity that is generally understood to drive consumption but is not intended to provide a basis for predicting the future performance of taxable retail sales or of the Commonwealth Sales Tax.

### General

The economy of Puerto Rico is closely linked to the United States economy, as most of the external factors that affect the Puerto Rico economy (other than the price of oil) are determined by the policies and performance of the economy of the United States. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures.

#### *Forecast for Fiscal Year 2008 and 2009*

The Planning Board's current real gross national product forecast for Fiscal Year 2008, which was released in March 2008, projected a decline of 2.1%, in constant dollars, or an increase of 3.4% in current dollars. Personal income is expected to increase by 0.8%, in real terms, or 4.3% in nominal terms<sup>1</sup>. The major factors affecting the economy are, among others, the continued increase of oil prices, the slowdown of the U.S. economic activity and the continuing economic uncertainty generated by the Commonwealth's fiscal crisis. The Planning Board expects real growth to return in Fiscal Year 2009, at 2.1%, or 7.1% in current dollars. This forecast assumed that the WTI oil price would be approximately \$86/bbl for fiscal year 2008, and that such prices would decline slightly to \$83/bbl for fiscal year 2009. However, fiscal year 2008 WTI oil prices will close at an average of \$97/bbl, and such prices could increase to \$120/bbl during fiscal year 2009. Therefore, oil prices are currently 12.8% above those forecasted for fiscal year 2008, and could increase 50% over the original forecast for fiscal year 2009. Moreover, the Planning Board forecast assumed that tax rebates to individuals would be implemented in fiscal year 2009, but they were actually implemented during the last quarter of fiscal year 2008, lowering the effects for fiscal year 2009. These outcomes would have a significant impact on the forecast of real GNP growth for fiscal year 2009, lowering its real growth rate below 1%, taking into account the high oil dependency of the Puerto Rican economy.

According to the Department of Labor and Human Resources Household Employment Survey (the "Household Survey"), the employment for the first eleven months of fiscal year 2008 averaged 1,214,800, a decrease of 3.8% compared to 1,262,900 for the same period of fiscal year 2007. At the same time, the unemployment rate for the first eleven months of fiscal year 2008 was 10.9%, an increase from 10.3% for the same period of fiscal year 2007.

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<sup>1</sup> Different price deflators are used for gross national product and personal income statistics. The year 2000 is used as a basis for comparison because that is the year used by the U.S. Department of Commerce.

## *Fiscal Year 2007*

The Planning Board's preliminary reports on the performance of the Puerto Rico economy for Fiscal Year 2007 indicate that real gross national product decreased 1.8% (3.5% in current dollars) over Fiscal Year 2006. Nominal gross national product was \$58.7 billion in Fiscal Year 2007 (\$44.3 billion in 2000 prices), compared to \$56.7 billion in Fiscal Year 2006 (\$45.1 billion in 2000 prices) to \$53.9 billion in fiscal year 2007 (\$44.4 billion in 2000 prices) and personal income per capita increased from \$13,033 in fiscal year 2006 (\$11,229 in 2000 prices), to \$13,491 in fiscal year 2007 (\$11,279 in 2000 prices).

According to the Household Survey, total employment for Fiscal Year 2007 averaged 1,262,900 an increase of 0.8% compared to 1,253,400 for Fiscal Year 2006. The driving force behind total employment is self-employment. The unemployment rate for Fiscal Year 2007 was 10.4%, a decrease from 11.7% for Fiscal Year 2006. As in the past, the economy of Puerto Rico followed the general performance and trends of the United States economy, although at a lower rate of growth.

Among the variables contributing to the Planning Board's downward revision in the forecast were the current effect of persistent high levels of oil prices, and the current slowdown of the United States Economy. Moreover, the continuing weakness of local construction investment has aggravated the current situation. The persistent high level of the price of oil and its derivatives (such as gasoline) has served to reduce the income available for other purchases and, thereby, negatively affected domestic demand. Due to the Commonwealth's dependence on oil for power generation and gasoline in spite of its recent improvements in power production diversification, the high level of oil prices is expected to account for an increased outflow of income in fiscal year 2008. The current financial difficulties associated with the subprime mortgage crisis have resulted in lowering of short-term interest rates. This could help alleviate the situation of the construction sector, which historically has been a major contributor to economic growth. The implementation of the tax reform legislation may reduce net disposable income even after giving effect to certain income tax reductions provided in the tax reform legislation.

### **Personal Income**

Personal income, both aggregate and per capita, increased consistently in each Fiscal Year from 1985 to 2007. In Fiscal Year 2007, aggregate personal income was \$53.1 billion (\$44.4 billion in 2000 prices) and personal income per capita was \$13,491 (\$11,279 in 2000 prices).<sup>2</sup> Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total federal payments to Puerto Rico, which amount to around \$12 billion annually and include transfers to local government entities and expenditures of federal agencies in Puerto Rico, in addition to federal transfer payments to individuals, are lower on a per capita basis in Puerto Rico than in any state of the United States. Eighty two percent (82%) of the transfer payments to individuals in Fiscal Year 2007 (\$8.9 billion), represented entitlements for previously performed services or resulting from contributions to programs such as Social Security, Veterans' Benefits, Medicare, and U.S. Civil Service retirement pensions. Grants represent the remainder of the federal transfers to individuals, mostly concentrated in the Nutritional Assistance Program (Food Stamps) and Pell Grant (higher education) Scholarships.

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<sup>2</sup> Different price deflators are used for gross national product and personal income statistics. The year 2000 is used as a basis for comparison because that is the year used by the U.S. Department of Commerce.



The following table shows the personal income for the five Fiscal Years ended June 30, 2007.

**Commonwealth of Puerto Rico**  
**Personal Income**  
**(in millions of dollars)**

	Fiscal Years Ended June 30,				
	2003	2004	2005	2006	2007 <sup>(1)</sup>
Employees' compensation					
Business	\$17,593.8	\$18,710.9	\$19,420.1	\$20,144.1	\$20,680.9
Government	6,947.6	7,388.5	8,150.5	8,424.2	8,586.3
Household and nonprofit institutions	656.3	711.0	704.8	737.2	756.6
Other	<u>985.1</u>	<u>958.6</u>	<u>1,085.3</u>	<u>1,036.7</u>	<u>1,026.4</u>
Total Employees' compensation	<u>\$26,182.8</u>	<u>\$27,768.9</u>	<u>\$29,360.7</u>	<u>\$30,342.2</u>	<u>\$31,050.2</u>
Less: Contributions for social insurance					
Employees	1,907.7	2,068.2	2,181.0	2,241.9	2,250.0
Employers	<u>2,777.3</u>	<u>2,884.9</u>	<u>3,061.6</u>	<u>3,167.1</u>	<u>3,152.0</u>
Total Contributions for social insurance	<u>\$4,684.9</u>	<u>\$4,953.0</u>	<u>\$5,242.6</u>	<u>\$5,409.0</u>	<u>5,402.0</u>
Proprietors' income					
Income of unincorporated enterprises	2,397.8	2,633.9	2,736.9	2,791.4	2,931.8
Dividends of domestic corporations	229.6	249.4	249.8	304.3	322.1
Miscellaneous income and dividends received from abroad	13.7	13.0	12.6	13.4	13.8
Rental income of persons	3,352.8	3,663.1	3,901.8	4,468.1	4,824.2
Personal interest income	<u>2,409.7</u>	<u>2,127.7</u>	<u>2,705.0</u>	<u>3,586.6</u>	<u>2,962.1</u>
Total Proprietors' income	<u>\$8,403.6</u>	<u>\$8,687.2</u>	<u>\$9,606.1</u>	<u>\$11,163.8</u>	<u>\$11,053.9</u>
Transfer payments					
Commonwealth government and municipalities	14,314.1	14,062.8	14,543.4	14,992.9	16,381.6
Federal government	3,119.3	3,290.3	3,324.2	3,390.7	3,577.4
U.S. state governments	9,391.5	8,903.0	9,243.7	9,725.9	10,466.3
Business	19.1	16.4	14.9	17.6	22.7
Other nonresidents	1,091.4	1,116.1	1,140.4	1,216.1	1,691.2
Total Personal Income	<u>692.9</u>	<u>737.0</u>	<u>820.3</u>	<u>642.6</u>	<u>624.0</u>
Total Personal Income	<u>\$44,215.6</u>	<u>\$45,565.9</u>	<u>\$48,267.6</u>	<u>\$51,089.9</u>	<u>\$53,083.7</u>

(1) Preliminary figures.

Source: Puerto Rico Planning Board, Program of Economic and Social Planning, Subprogram of Economic Analysis

**Personal Consumption**

During Fiscal Year 2007, at current prices, personal consumption amounted to \$51.9 billion, increasing by \$2.4 billion or 4.8% from the amount of \$49.5 billion for Fiscal Year 2006. At constant prices, personal consumption increased 1.8% from Fiscal Year 2006. Such an increase was based on a 3.4% increase in nondurable goods (39% of personal consumption), 1.1% increase in durable goods (18% of personal consumption), and 0.6% increase in services (43% of personal consumption). These figures are characteristic of an economy in recession, where durable goods and services are the most affected categories.

The following table shows personal consumption expenditures by product for the five Fiscal Years ended June 30, 2007.

**Commonwealth of Puerto Rico**  
**Personal Consumption Expenditures by Product**  
(in millions of dollars)

	Fiscal Years Ended June 30,				
	2003	2004	2005	2006	2007 <sup>(1)</sup>
Food	\$ 5,984.0	\$ 6,061.2	\$ 6,573.9	\$ 6,982.2	\$ 7,259.2
Alcoholic beverages and tobacco products	1,513.4	1,540.8	1,435.5	1,803.1	1,837.9
Clothing and accessories	2,693.6	2,851.9	2,957.1	3,073.3	3,510.2
Personal care	752.8	782.2	815.5	984.6	1,052.4
Housing	6,093.1	6,549.4	7,012.3	7,499.7	8,010.0
Household operations	4,569.1	4,773.4	5,268.2	5,929.2	6,485.5
Medical care and funeral expenses	6,960.4	7,162.5	7,527.7	7,944.1	8,305.7
Business services	2,881.5	2,962.7	3,055.8	3,042.5	2,985.6
Transportation	4,870.4	5,283.7	6,136.4	6,404.5	6,300.3
Recreation	3,800.1	4,401.9	4,531.6	4,699.9	4,942.9
Education	1,345.3	1,589.3	1,627.8	1,686.3	1,709.3
Religious and nonprofit organizations, not elsewhere classified	418.8	473.3	482.3	508.4	511.5
Foreign travel	1,274.2	1,450.1	1,539.3	1,608.9	1,616.9
Miscellaneous purchases	<u>520.0</u>	<u>565.7</u>	<u>605.8</u>	<u>704.1</u>	<u>819.4</u>
Total consumption expenditures in Puerto Rico by residents and nonresidents	<u>\$43,676.8</u>	<u>\$46,448.6</u>	<u>\$49,569.2</u>	<u>\$52,870.9</u>	<u>\$55,346.8</u>
Less: Expenditures in Puerto Rico by nonresidents	<u>2,703.3</u>	<u>3,052.6</u>	<u>3,269.4</u>	<u>3,403.1</u>	<u>3,457.4</u>
Total Personal Consumption Expenditures	<u>\$40,973.4</u>	<u>\$43,396.0</u>	<u>\$46,299.8</u>	<u>\$49,467.8</u>	<u>\$51,889.4</u>

(1) Preliminary figures.

Source: Puerto Rico Planning Board, Program of Economic and Social Planning, Subprogram of Economic Analysis.

## Gross National Product

The dominant sectors of the Puerto Rico economy in terms of production and income are manufacturing and services. The manufacturing sector has undergone fundamental changes over the years as a result of increased emphasis on higher wage, high technology industries, such as pharmaceuticals, biotechnology, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. The services sector, including finance, insurance, real estate, wholesale and retail trade, and tourism, also plays a major role in the economy. It ranks second to manufacturing in contribution to the gross domestic product and leads all sectors in providing employment.

The following table shows the gross national product for the five Fiscal Years ended June 30, 2007.

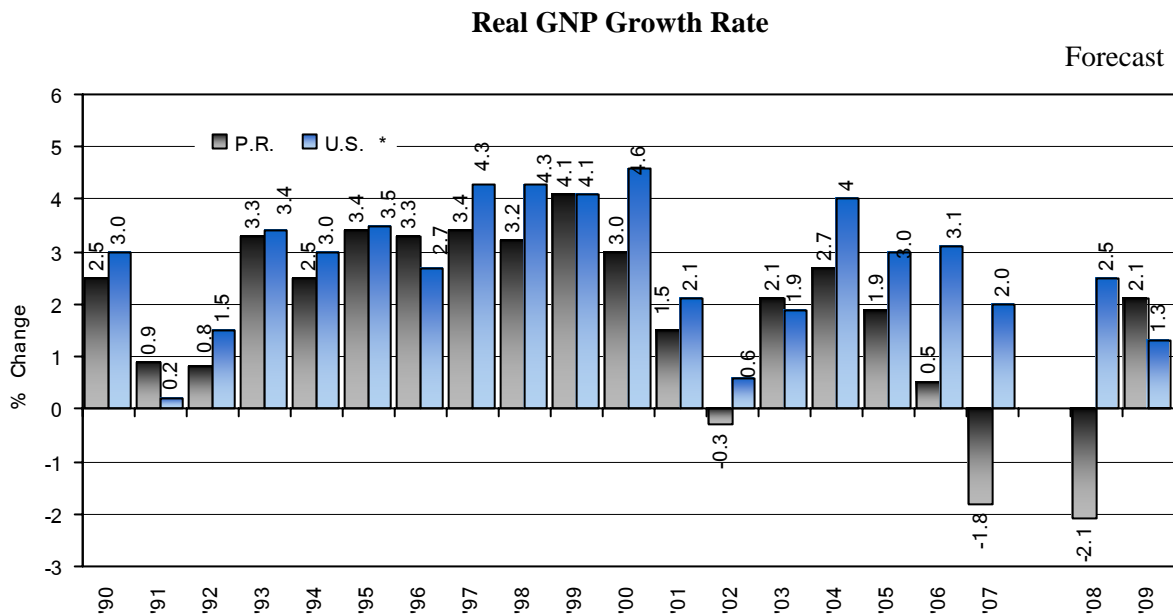
**Commonwealth of Puerto Rico  
Gross National Product**

	Fiscal Years Ended June 30,				
	2003	2004	2005	2006	2007 <sup>(1)</sup>
Gross national product – \$ millions <sup>(2)</sup>	\$47,479	\$50,709	\$53,752	\$56,733	\$58,712
Real gross national product – \$ millions (2000 prices)	42,795	43,967	44,819	45,061	44,252
Annual percentage increase in real gross national product (2000 prices)	2.1%	2.7%	1.9%	0.5%	(1.8)%
U.S. annual percentage increase in real gross national product (2000 prices)	1.9%	4.0%	3.0%	3.1%	2%

- (1) Preliminary.  
(2) In current dollars.

Sources: Puerto Rico Planning Board and Global Insight Inc.

The following graph compares the growth rate of real gross national product for the Puerto Rico and United States economies since Fiscal Year 1990, and the forecast of the growth rate for Fiscal Years 2008 and 2009. The graph also shows a slight slowdown in fiscal year 2007, and a significant slowdown which is expected for fiscal year 2009.



Source: Global Insight 03/08.

## Economic Performance by Sector

### General

From Fiscal Year 2003 to Fiscal Year 2007, the manufacturing and services sectors generated the largest portion of gross domestic product. The three sectors of the economy that provide the most employment are manufacturing, services and government.

The following table presents annual statistics of gross domestic product by sector and gross national product for the five Fiscal Years ended June 30, 2003 through 2007.

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

	<b>Fiscal Years Ended June 30</b>				
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007<sup>(1)</sup></b>
Manufacturing	\$31,532	\$33,267	\$34,534	\$36,547	\$36,717
Services <sup>(2)</sup>	28,919	30,476	32,449	33,948	35,925
Government <sup>(3)</sup>	6,948	7,389	8,150	8,424	8,586
Transportation, communication and public utilities	5,178	5,343	5,309	5,701	5,971
Agriculture, forestry and fisheries	333	414	375	385	441
Construction <sup>(4)</sup>	1,772	1,905	1,848	1,807	1,875
Statistical discrepancy	146	415	144	131	186
Total gross domestic product <sup>(5)</sup>	<u>\$74,827</u>	<u>\$79,209</u>	<u>\$82,809</u>	<u>\$86,943</u>	<u>\$89,701</u>
Less: net payment abroad	<u>(27,348)</u>	<u>(28,501)</u>	<u>(29,056)</u>	<u>(30,210)</u>	<u>(30,989)</u>
Total gross national product <sup>(5)</sup>	<u><u>\$47,479</u></u>	<u><u>\$50,709</u></u>	<u><u>\$53,753</u></u>	<u><u>\$56,733</u></u>	<u><u>\$58,712</u></u>

(1) Preliminary.

(2) Includes wholesale and retail trade, finance, insurance and real estate, tourism, and other services.

(3) Includes the Commonwealth, its municipalities and certain public corporations, and the federal government. Excludes certain other public corporations, like the Electric Power Authority and the Aqueduct and Sewer Authority whose activities are included under Services in the table.

(4) Includes mining.

(5) Totals may not add due to rounding.

Source: Planning Board

The data for employment by sector or industries presented here, like in the United States, are based on the Payroll Employment Survey (the "Payroll Survey"), which is designed to measure employment by sector. The Payroll Survey excludes agricultural employment and self-employed persons.

The following table presents annual statistics of average employment based on the North American Industry Classification System (NAICS) for Fiscal Years 2003 to 2007.

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007<sup>(2)</sup></u>
Natural Resources and Construction	68,525	69,300	68,233	67,442	67,392
Manufacturing					
Durable Goods	48,567	48,808	48,067	46,492	44,850
Non-Durable Goods	70,192	69,633	69,250	66,367	60,958
Sub Total	<u>118,759</u>	<u>118,441</u>	<u>117,317</u>	<u>112,859</u>	<u>105,808</u>
Trade, Transportation, Warehouse & Utilities					
Wholesale Trade	32,183	33,300	33,717	33,992	33,158
Retail Trade	130,183	132,008	136,192	137,800	135,058
Transportation, Warehouse & Utilities	17,358	17,042	17,617	17,433	16,700
Sub Total	<u>179,724</u>	<u>182,350</u>	<u>187,526</u>	<u>189,225</u>	<u>184,916</u>
Information	21,617	21,917	22,608	22,600	21,733
Finance	44,667	46,850	48,633	49,767	49,975
Professional & Business	98,500	101,900	103,767	106,400	104,767
Educational & Health	92,408	98,108	99,967	103,583	105,842
Leisure & Hospitality	67,917	70,317	72,592	74,767	73,433
Other Services	18,858	20,671	21,257	21,267	22,283
Government	297,717	303,408	307,825	302,025	297,450
Total Non-Farm	<u>1,008,692</u>	<u>1,033,262</u>	<u>1,049,725</u>	<u>1,049,935</u>	<u>1,033,599</u>

### *Manufacturing*

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board figures show that in fiscal year 2007 manufacturing generated \$36.7 billion, or 40.9%, of gross domestic product. During fiscal year 2007, payroll employment for the manufacturing sector was 105,808, a decrease of 6.2% compared with fiscal year 2006. Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semi-finished manufactured articles on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. As of February, 2008, the average hourly manufacturing wage rate in Puerto Rico was 68.0% of the average mainland United States rate.

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 large investments over the last decade in the pharmaceutical, scientific instruments, computers and electrical products industries in Puerto Rico. One of the factors encouraging 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 U.S. Code, phased out these federal tax incentives during a ten-year period that recently ended. This change has had a long term impact on local manufacturing activity.

The following table sets forth gross domestic product by manufacturing sector for the five fiscal years ended June 30, 2003 through June 30, 2007.

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

	<b>Fiscal Years Ended June 30,</b>				
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Pharmaceuticals	\$18,998	\$19,814	\$20,705	\$21,837	\$21,511
Machinery and metal products:					
Machinery, except electrical	3,507	3,372	3,307	3,215	3,210
Electrical machinery	1,771	1,818	1,904	1,852	1,811
Professional and scientific instruments	2,981	3,540	3,698	4,157	4,364
Other machinery and metal products	288	274	283	285	293
Food products	1,903	2,202	2,312	2,958	3,146
Other chemical and allied products	502	591	613	624	375
Apparel	353	344	325	228	222
Other <sup>(1)</sup>	1,231	1,312	1,387	1,391	1,785
Total gross domestic product of manufacturing sector <sup>(2)</sup>	<u>\$31,532</u>	<u>\$33,267</u>	<u>\$34,534</u>	<u>\$36,547</u>	<u>\$36,717</u>

(1) Includes petroleum products; petrochemicals; tobacco products; stone, clay and glass products; textiles and others.

(2) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average manufacturing employment by industry based on the North American Industry Classification System (NAICS) for fiscal years 2003 to 2007.

**Commonwealth of Puerto Rico**  
**Non-Farm Payroll Manufacturing Employment by Industry Group\***  
**(persons age 16 years and over)**

<b>Industry Group</b>	<b>Fiscal Years Ended June 30,</b>				
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007<sup>(1)</sup></b>
<b><u>Durable Goods</u></b>					
Nonmetallic Mineral Products Manufacturing	4,444	4,706	4,471	4,108	3,792
Cement and Concrete Products Manufacturing	3,543	3,867	3,750	3,542	3,208
Fabricated Metal Products	6,198	6,490	6,427	5,808	5,817
Computer and Electronic	11,623	10,581	10,673	10,808	10,133
Electrical Equipment	7,415	7,744	7,645	6,858	6,567
Electrical Equipment Manufacturing	4,399	4,935	4,971	4,708	4,525
Miscellaneous Manufacturing	12,308	12,070	11,157	11,225	11,200
Medical Equipment and Supplies Manufacturing	11,336	11,059	10,473	10,492	10,467
Other Durable Goods Manufacturing	7,646	8,185	7,693	7,685	7,341
Total – Durable Goods	<u>49,634</u>	<u>49,776</u>	<u>48,066</u>	<u>46,492</u>	<u>44,850</u>
<b><u>Non-Durable Goods</u></b>					
Food Manufacturing	13,628	13,244	13,050	12,667	12,433
Beverage and Tobacco Products Manufacturing	3,159	3,038	3,175	3,425	3,267
Apparel Manufacturing	8,988	8,522	8,873	8,400	7,250
Cut and Sew Apparel Manufacturing	8,969	8,518	8,846	8,183	6,933
Chemical Manufacturing	31,183	31,385	32,885	32,335	30,067
Pharmaceutical and Medicine Manufacturing	26,645	27,187	28,572	28,017	25,742
Plastics and Rubber Products	3,340	3,210	2,744	2,350	2,217
Plastics Product Manufacturing	3,030	2,917	2,266	2,158	2,083
Other Non-Durable Goods Manufacturing	8,823	9,261	8,529	7,200	5,724
Total – Non-Durable Goods	<u>69,121</u>	<u>68,660</u>	<u>69,256</u>	<u>66,367</u>	<u>60,958</u>
Total Manufacturing Employment	<u><u>118,755</u></u>	<u><u>118,436</u></u>	<u><u>117,322</u></u>	<u><u>112,869</u></u>	<u><u>105,808</u></u>

\* Totals may not add due to rounding.

(1) Preliminary.

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

Total employment in the manufacturing sector decreased by 12,947 from fiscal year 2003 to fiscal year 2007. Manufacturing employment had been declining during the past decade, but the decline accelerated during fiscal years 2002 and 2003, falling -10.6% and -4.8%, respectively. After that, manufacturing employment seemed to stabilize around 118,000 jobs, but the deceleration reappeared in fiscal year 2006 with the sector experiencing another significant drop of -3.8%. For fiscal year 2007 the

employment decline accelerated further to -6.2%. During the last year the economy has lost around 7,050 jobs in the manufacturing sector. There are several reasons which explain this sector's job shrinkage: the end of the phase-out of Section 936, the net loss of patents on certain pharmaceutical products, the escalation of manufacturing production costs (particularly labor and electricity), and the increased use of job outsourcing. Puerto Rico's manufacturing sector is facing increased international competition, and new ideas and initiatives are necessary to improve this sector.

### *Services*

Puerto Rico has experienced significant growth in the services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism and other services, in terms of both income and employment over the past decade, showing a favorable trend as compared with certain other industrialized economies. During the period between fiscal years 2003 and 2007, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 5.4%, while payroll employment in this sector increased at an average annual rate of 1.8%. In the Puerto Rico labor market, self-employment, which is not accounted for in the Payroll Survey, represents approximately 17% of total employment according to the Household Survey. Most of the self-employment is concentrated in the service and construction sectors. For example, for fiscal year 2006, the number of self-employed individuals was 182,914, out of which 46.8% were in the services sector and 15.1% were in the construction sector. The development of the services sector has been positively affected by demand generated by other sectors of the economy, such as manufacturing, construction and agriculture. The services sector in Puerto Rico has a diversified base.

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

The services sector ranks second to manufacturing in its contribution to gross domestic product, and it is the sector with the greatest employment. In fiscal year 2007, services generated \$35.9 billion of gross domestic product, or 40% of the total. Services employment grew from 523,691 in fiscal year 2003 to 562,949 in fiscal year 2007 (representing 54.5% of total, non-farm, payroll employment). This represents a cumulative increase of 7.5% during such period. Wholesale and retail trade, finance, insurance and real estate experienced significant growth in fiscal years 2003 to 2007, as measured by gross domestic product. From fiscal year 2003 to 2007, gross domestic product increased in wholesale and retail trade from \$9.2 billion to \$11.1 billion, and in finance, insurance, and real estate from \$12.5 billion to \$16.3 billion. There are sixteen commercial banks and trust companies currently operating in Puerto Rico. Total assets of these institutions as of December 31, 2007 were \$113.9 billion. As of December 31, 2007, there were approximately thirty-five international banking entities operating in Puerto Rico licensed to conduct offshore banking transactions with total assets of \$75.8 billion.



The following tables set forth gross domestic product for fiscal years 2003 to 2007 and employment for the services sector for fiscal years 2003 to 2007.

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

	<b>Fiscal Years Ended June 30,</b>				
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007<sup>(1)</sup></b>
Wholesale and retail trade	\$ 9,150	\$ 9,802	\$10,217	\$10,709	\$11,061
Finance, insurance and real estate	12,508	13,029	14,267	14,998	16,336
Other services <sup>(2)</sup>	7,261	7,646	7,965	8,241	8,529
Total	<u>\$28,919</u>	<u>\$30,476</u>	<u>\$32,449</u>	<u>\$33,948</u>	<u>\$35,925</u>

\* Totals may not add due to rounding.

(1) Preliminary.

(2) Includes tourism.

Source: Planning Board.

**Commonwealth of Puerto Rico**  
**Non-Farm Payroll Employment by Services Sector\***  
**(thousands of persons age 16 and over)**

	<b>Fiscal Years Ended June 30,</b>				
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007<sup>(1)</sup></b>
Wholesale Trade	32,181	33,299	33,710	33,992	33,158
Retail Trade	130,180	132,008	136,189	137,800	135,058
Transportation, Warehouse & Utilities	17,352	17,054	17,615	17,433	16,700
Trade, Transportation, Warehouse & Utilities	<u>179,713</u>	<u>182,361</u>	<u>187,514</u>	<u>189,225</u>	<u>184,916</u>
Information	21,619	21,907	22,598	22,600	21,733
Finance	44,648	46,852	48,621	49,767	49,975
Professional and Business	98,498	101,899	103,767	106,400	104,767
Educational & Health	92,409	98,101	99,963	103,583	105,842
Leisure & Hospitality	67,912	70,310	72,586	74,767	73,433
Other Services	18,808	20,671	21,257	21,267	22,283
Total	<u>523,607</u>	<u>542,101</u>	<u>556,306</u>	<u>567,609</u>	<u>562,949</u>

\* Totals may not add due to rounding.

(1) Preliminary.

Source: Department of Labor and Human Resources, Benchmark on Employment, Hours and Earnings

*Hotels and Related Services – Tourism*

During fiscal year 2006, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists staying in more than one hotel during their visit, was 1,913,400, an increase of 3.4% over the number of persons registered during the same period in fiscal year 2005. The number of non-resident tourists registered in tourist hotels during fiscal year 2006 increased 4.6% compared to fiscal year 2005. Hotel rooms available during fiscal year 2006 increased 3.9% compared to fiscal year 2005. The

average number of rooms rented in tourist hotels increased 3.9% during fiscal year 2006 compared to fiscal year 2005. The average occupancy rate in tourist hotels during fiscal years 2005 and 2006 was 70.8%.

During fiscal year 2007, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists staying in more than one hotel during their visit, was 1,798,300, a decrease of 6.5% over the number of persons registered during fiscal year 2006. The average occupancy rate in tourist hotels during fiscal year 2007 was 71.3%, compared to 70.1% during fiscal year 2006. The average number of rooms rented in tourist hotels decreased 5.0% fiscal year 2007 compared with fiscal year 2006. The average number of rooms available in tourist hotels decreased 6.3% from fiscal year 2006 to fiscal year 2007 as the completion of regular maintenance and rehabilitation of rooms (that normally results in a certain number of rooms being unavailable at any time) took longer to complete than in the past.

The number of persons registered in tourist hotels during the first nine months of fiscal year 2008, was 1,331,700, a decrease of 2.2% over the number of persons registered during the same period of fiscal year 2007. The average occupancy rate in tourist hotels during the first four months of fiscal year 2008 was 68.2%, compared to 68.4% in the period for fiscal year 2007. During the first four months of fiscal year 2008, the average number of rooms rented in tourist hotels decreased 2.3% and the average number of rooms available in tourist hotels decreased 2.7% compared with the same period in fiscal year 2007.

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

The following table presents data relating to visitors to Puerto Rico and tourist expenditures for the five fiscal years ended June 30, 2007.

**Commonwealth of Puerto Rico  
Tourism Data<sup>(1)</sup>  
Number of Visitors**

<b>Fiscal Years Ended June 30,</b>	<b>Tourist Hotels<sup>(2)</sup></b>	<b>Cruise Ship</b>	<b>Other<sup>(3)</sup></b>	<b>Total</b>	<b>Total Visitors' Expenditures (in millions)</b>
2003.....	1,239,200	1,163,900	1,999,200	4,402,300	2,676.6
2004.....	1,307,000	1,348,200	2,234,000	4,889,200	3,024.0
2005.....	1,361,640	1,386,925	2,324,275	5,072,840	3,238.6
2006.....	1,424,170	1,300,120	2,297,840	5,022,130	3,369.3
2007 <sup>(4)</sup> .....	1,353,380	1,375,430	2,333,600	5,062,410	3,143.9

(1) Only includes information about non-resident tourists registering in tourist hotels. They are counted once even if registered in more than one hotel.

(2) Includes visitors in guesthouses.

(3) Includes visitors in homes of relatives, friends, and in hotel apartments.

(4) Preliminary

Sources: Puerto Rico Tourism Company and the Planning Board

The Commonwealth, through the Convention Center District Authority, has completed the development of the largest convention center in the Caribbean, and the centerpiece of a 100-acre, private development, to include hotels, restaurants, cinemas, office space and housing. The convention center district is being developed at a total cost of \$1.3 billion to improve Puerto Rico's competitive position in the convention and group travel segments. The convention center opened on November 17, 2005.

The Convention Center District Authority also owns a multi-purpose coliseum located in San Juan, Puerto Rico. The coliseum, known as the Jose Miguel Agrelot Coliseum, was inaugurated in 2004 and has been host to various successful artistic and other events.

### *Government*

The government sector of Puerto Rico plays an important role in the economy. In fiscal year 2007, the government accounted for \$8.6 billion of Puerto Rico's gross domestic product, or 9.6% of the total. The government is also a significant employer, providing jobs for 297,400 workers, or 28.8% of total, non-farm, payroll employment in fiscal year 2006. This total includes municipal employees. As of January 31, 2008, central government employment has been reduced by approximately 11,500 positions since September 2004.

On February 25, 1998, legislation was enacted permitting the unionization of employees of the central government (excluding municipal employees). Under this law, government employees are given collective bargaining rights subject to a number of limitations. Among those limitations are: employees are prohibited from striking; salary increases are contingent on the availability of budgeted revenues; employees cannot be required to become union members and pay union dues; and collective bargaining negotiations cannot occur in an election year. During fiscal year 2006, the Commonwealth and its instrumentalities began to negotiate the economic and non-economic terms of at least forty collective bargaining agreements. The results of these negotiations could have a material impact on the General Fund.

### *Transportation*

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

Luis Muñoz Marín International Airport is currently served by 25 United States and international airlines. At present, there is daily direct service between San Juan and Atlanta, Boston, Chicago, Dallas, Miami, New York, Philadelphia, and numerous other destinations within the United States. There is also regularly scheduled service between Aguadilla and Ponce and New York and between Puerto Rico and other Caribbean islands and certain Latin American and European cities. A major United States airline uses San Juan as a hub for its intra-Caribbean airline service. Several smaller airports serve intra-island traffic.

The island's major cities are connected by a modern highway system, which, as of December 31, 2006, totaled approximately 4,621 miles. The highway system comprises 391 miles of primary system highways, which are the more important interregional traffic routes and include PR-52, PR-22, PR-53 and PR-20 toll highways, 230 miles of primary urban system highways, 959 miles of secondary system highways serving the needs of intra-regional traffic and 3,041 miles of tertiary highways and roads serving local, intra-regional traffic.

The first phase of a new mass transit system, known as Tren Urbano, has been completed. Tren Urbano serves a portion of metropolitan San Juan and is expected eventually to serve the municipalities of Carolina and Caguas as well. It currently has ridership of about 33,000 per day.

The Port of the Americas Authority ("PAA") is responsible for the development and operation of the Port of the Americas, a deep draft port on the south coast of Puerto Rico. The first phase of the Port of the Americas was completed in fiscal year 2004. This initial phase included the improvement of piers 4, 5 and 6 of the Port and the acquisition of heavy equipment at a cost of \$40 million. During calendar year 2005, the PAA began the second phase of the Port, which phase is expected to be completed by the end of calendar year 2008. Completion of this second phase will provide capacity to handle up to 250,000 Twenty-Foot Equivalent Units ("TEU"). This second phase includes (i) dredging the entrance channel and adjacent areas of the Port to a depth of 50 feet; (ii) reconstructing the container terminals; (iii) commencing certain required

environmental risk mitigation procedures; and (iv) preparing final construction schematics. With respect to these tasks, dredging is completed, the final design contract has been awarded, acquisition of environmental risk mitigation land is underway, and the contract for reconstruction of the container terminal was awarded in April 2006. The Port is expected to be capable of providing capacity for up to 700,000 TEUs when the third phase is completed.

As of September 30, 2007, PAA had an outstanding balance of \$94.6 million under various lines of credit from GDB. PAA is authorized to borrow up to \$250 million under these lines of credit. This debt is payable from annual legislative appropriations until the PAA starts generating revenues sufficient to cover debt service and is also guaranteed by the Commonwealth. Partial operation of the Port of the Americas, at a capacity of up to 250,000 TEUs per year, could begin in early 2008.

### *Construction*

Although the construction industry represents a relatively small segment of the economy compared to other sectors, it has made significant contributions to the growth of economic activity, due to its multiplier effect on the whole economy. During the period from fiscal year 2003 through fiscal year 2007, however, real construction investment has decreased at an average annual growth rate of 5.9%. The total value of construction permits decreased by 5.4% during the same five fiscal year period.

Public investment has been an important component of construction investment. During fiscal year 2007, approximately 43.4% of the total investment in construction was related to public projects. For fiscal year 2007 compared to fiscal year 2006, the total value of construction permits decreased 22.2% and total sales of cement, including imports, decreased 8.2%. Average payroll employment in the construction sector during fiscal year 2007 was 67,400, a reduction of 0.1% from fiscal year 2006. Cement sales (including imports) continued their decline, during the first three quarters of fiscal year 2008, falling 11.4% compared to the same period in fiscal year 2007.

Total construction investment for fiscal year 2007 decreased (in real terms) by 6.3% (following a 10.4% real decline in fiscal year 2006) due principally to the drop in construction related public projects. For fiscal year 2008, the Planning Board forecasts further construction investment decreases (in real terms) of 5.3% and stagnation (0% real growth) for fiscal year 2009. Public investment will be primarily in housing, new schools (and school reconstruction programs), water projects, and other public infrastructure projects. Public investment in construction has been negatively affected by the Commonwealth's fiscal difficulties.

During the first ten months of fiscal year 2008, the number of construction permits decreased 12.1% and the total value of construction permits increased 24.2% compared to the same period in fiscal year 2007.

### *Agriculture*

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and the quality of produce, and stimulating the consumption of locally produced agricultural products. During fiscal year 2007, gross income from agriculture was \$814.2 million, an increase of 1.6% compared with fiscal year 2006. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include traditional crops, livestock and poultry, grains, vegetables, fruits, ornamental plants and other products. During fiscal year 2007, starchy vegetables, coffee, livestock products and ornamental plants contributed a higher percentage of the sector's income than in the previous fiscal year.

The Commonwealth supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. Act No. 225 of 1995 provides a 90% income tax exemption for income derived from agricultural operations, an investment tax credit equal to 50% of the investment in qualified agricultural projects, and a 100%

exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from bonds, notes and other debt instruments issued by financial institutions to provide financing to agricultural businesses. Subsequent legislation imposed an aggregate annual limit of \$15 million on the investment tax credits available under Act No. 225.

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

### Employment and Unemployment

The number of persons employed in Puerto Rico during fiscal year 2007 averaged 1,262,900, a 0.8% increase from 1,253,400 in fiscal year 2006. Unemployment, although at relatively low historical levels, is about twice the United States average. The average unemployment rate decreased from 11.7% in fiscal year 2006 to 10.4% in fiscal year 2007.

The following table presents annual statistics of employment and unemployment for fiscal year 2003 through fiscal year 2007 and monthly statistics, seasonally adjusted, for the first eight months of fiscal year 2008. These employment figures are based on the Household Survey, which includes self-employed individuals, instead of the non-farm, payroll employment survey (the “Payroll Survey”), which does not. The number of self-employed individuals represents around 17% of civilian employment in Puerto Rico, more than double the level in the United States.

**Commonwealth of Puerto Rico  
Employment and Unemployment<sup>(1)</sup>  
(persons age 16 and over)  
(in thousands)**

<u>Fiscal Years Ended June 30,</u>	<u>Labor Force</u>	<u>Employed</u>	<u>Unemployed</u>	<u>Unemployment Rate<sup>(2)</sup></u>
		<b>(Annual Average)</b>		
2003 .....	1,352	1,188	164	12.1%
2004 .....	1,360	1,206	155	11.4
2005 .....	1,385	1,238	147	10.6
2006 .....	1,420	1,253	167	11.7
2007 .....	1,409	1,263	147	10.4
		<b>(Seasonally Adjusted)</b>		
<b><u>Fiscal Year 2008</u></b>				
July .....	1,389	1,226	163	11.8%
August .....	1,412	1,279	133	9.4
September .....	1,364	1,213	151	11.1
October .....	1,372	1,210	163	11.9
November .....	1,369	1,217	151	11.0
December .....	1,361	1,209	152	11.2
January .....	1,374	1,226	148	10.8
February .....	1,374	1,216	158	11.5

(1) Totals may not add due to rounding.

(2) Unemployed as percentage of labor force.

Source: Department of Labor and Human Resources – Household Survey

## Higher Education

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

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

### Commonwealth of Puerto Rico Trend in College Enrollment

Academic Year	Commonwealth of Puerto Rico			Mainland United States		
	Population 18-24 Years of Age	Higher Education Enrollment	Percent <sup>(1)</sup>	Population 18-24 Years of Age	Higher Education Enrollment	Percent <sup>(1)</sup>
1970	341,448 <sup>(2)</sup>	57,340	16.8%	23,714,000 <sup>(2)</sup>	8,580,887	36.2%
1980	397,839 <sup>(2)</sup>	130,105	32.7%	30,022,000 <sup>(2)</sup>	12,096,895	40.3%
1990	417,636 <sup>(2)</sup>	156,147	37.4%	26,961,000 <sup>(2)</sup>	13,621,000	50.5%
2000	428,892 <sup>(2)</sup>	176,015	41.0%	27,143,455 <sup>(2)</sup>	15,313,000	56.4%
2001	426,194 <sup>(3)</sup>	185,015	43.4%	27,971,000 <sup>(3)</sup>	15,928,000	56.9%
2002	423,852 <sup>(3)</sup>	190,776	45.0%	28,463,000 <sup>(3)</sup>	16,612,000	58.4%
2003	420,295 <sup>(3)</sup>	199,842	47.5%	28,947,000 <sup>(3)</sup>	16,900,000	58.4%
2004	416,020 <sup>(3)</sup>	207,074	49.8%	29,245,000 <sup>(3)</sup>	17,272,000	59.1%
2005	411,580 <sup>(3)</sup>	208,032	50.5%	29,307,000 <sup>(3)</sup>	17,428,000	59.5%

(1) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age.

(2) Based on census population as of April 1 of the stated year.

(3) Estimated population (reference date July 1 of the stated year).

*Sources:* United States Census Bureau (Mainland United States Population), United States National Center for Education Statistics, Planning Board (Puerto Rico Population) and Council on Higher Education of Puerto Rico

The University of Puerto Rico, the only public university in Puerto Rico, has eleven campuses located throughout the island. The University's total enrollment for academic year 2006-2007 was approximately 62,340 students. The Commonwealth is legally bound to appropriate annually for the University of Puerto Rico an amount equal to 9.60% of the average annual revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

In addition to the University of Puerto Rico, there are 40 public and private institutions of higher education located in Puerto Rico. Such institutions had an enrollment during academic year 2005-2006 of approximately 145,574 students and provide programs of study in liberal arts, education, business, natural

sciences, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

Enrollment at other postsecondary education programs, including technical and vocational programs, amounted to an additional 33,629 students at approximately 76 institutions. This figure represents enrollment at federal Title IV eligible, non-degree granting institutions reporting data to the National Center for Education Statistics (Integrated Postsecondary Education Data System).

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

## **Tax Incentives**

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

### *Industrial Incentives Program*

Since 1948, Puerto Rico has had various industrial incentives laws designed to stimulate industrial investment in the island. Under these laws, which are designed to promote investment in Puerto Rico, companies engaged in manufacturing and certain other designated activities were eligible to receive full or partial exemption from income, property, and other local taxes. The industrial incentives law currently in force is Act No. 135 of December, 1997 known as the Tax Incentives Act of 1998 ("Act 135"), which expires on June 30, 2008. This law will be replaced by Act No. 73 of May 28, 2008 known as the Economic Incentives Act for the Development of Puerto Rico ("Act 73"), and will be effective on July 1, 2008.

The benefits provided by Act 135 are currently available to new companies as well as companies currently conducting tax-exempt operations in Puerto Rico that choose to renegotiate their existing tax exemption grant, expand current operations or commence operating a new eligible business. The activities eligible for tax exemption include manufacturing, certain designated services performed for markets outside Puerto Rico (including the United States), the production of energy from local renewable sources for consumption in Puerto Rico and laboratories for research and development. Companies qualifying thereunder can benefit from income tax rates ranging from 2% to 7% for periods ranging from 10 to 25 years. In addition, Act 135 grants 90% exemption from property taxes, 100% exemption from municipal license taxes during the first three semesters of operations and between 60% and 80% thereafter, and 100% exemption from excise taxes with respect to the acquisition of raw materials and certain machinery and equipment used in the exempt activities. Act 135 also provides various special deductions designed to stimulate employment and productivity, research and development and capital investment in Puerto Rico.

An exempt business currently under Act 135 will be able to continue to enjoy the benefits provided in said act and its current grant of industrial tax exemption until expiration or may elect to convert said grant to Act. 73. In case of a conversion, if the exempt business is subject to a fixed income tax rate of no more than 4% and no less than 2%, it will be able to retain its fixed income tax rate under Act 135 and its current grant, but will be required to maintain at least 80% of the average employment of the last three taxable years.

Under Act 73, the activities eligible for tax exemption include manufacturing, services, production of energy, recycling and value added activities among others. Companies qualifying thereunder can benefit from income tax rates of 4% (with a withholding tax on royalty payments of 12%) or 8% (with a withholding tax on royalty payments of 2%) for 15 year periods. Pioneer products can benefit from a fixed income tax rate of 1%, or of 0%, if the intangible property used has been created or developed in Puerto Rico, including

but not limited to activities geared to the commercial viability of the product. In addition, Act 73 will grant a 90% exemption from personal and real property taxes and a 60% exemption from municipal license taxes. For small and medium size businesses there will be a 75% municipal license tax exemption.

Act 73 will provide a 100% state excise tax and sales and use tax exemption on raw materials; machinery and equipment; fuel used for the generation of energy; chemicals used in the treatment of waste water; and energy efficient equipment. It will also provide an income tax credit for the purchase of products manufactured in Puerto Rico; the creation of employment; clinical and toxicology trials; and for the investment in machinery and equipment for the generation of energy, among others. Certain credits against the fixed income tax rate are provided under Act 73.

#### *Tourism Incentives Program*

For many years, Puerto Rico has also had incentives laws designed to stimulate investment in hotel operations on the island. The most recent of these laws, the Tourism Incentives Act of 1993 (the “Tourism Incentives Act”), provides partial exemptions from income, property, and municipal license taxes for a period of up to ten years. The Tourism Incentives Act also provides certain tax credits for qualifying investments in tourism activities, including hotel and condo-hotel development projects. Recently enacted legislation provides further tourism incentives by granting certain tax exemptions on interest income received from permanent or interim financing of tourism development projects and fees derived from credit enhancements provided to the financing of such projects.

As part of the incentives to promote the tourism industry, the Commonwealth established the Tourism Development Fund as a subsidiary of GDB with the authority to (i) make investments in or provide financing to entities that contribute to the development of the tourism industry and (ii) provide financial guarantees and direct loans for financing hotel development projects. To date, the Fund has provided direct loans and financial guarantees for loans made or bonds issued to finance the development of seventeen hotel projects representing over 3,900 new hotel rooms.

#### *Incentives under the U.S. Code*

United States corporations operating in Puerto Rico have been subject to special tax provisions since the Revenue Act of 1921. Prior to enactment of the Tax Reform Act of 1976, under Section 931 of the U.S. Code, United States corporations operating in Puerto Rico (and meeting certain source of income tests) were taxed only on income arising from sources within the United States.

The Tax Reform Act of 1976 created Section 936 of the U.S. Code, which revised the tax treatment of United States corporations operating in Puerto Rico by taxing such corporations on their worldwide income in a manner similar to that applicable to any other United States corporation but providing such corporations a full credit for the federal tax on their business and qualified investment income in Puerto Rico. The credit provided an effective 100% federal tax exemption for operating and qualifying investment income from Puerto Rico sources.

As a result of amendments to Section 936 of the U.S. Code made in 1996 (the “1996 Amendments”), its income tax credit based on operating and certain investment income was phased out over a ten-year period for companies that were operating in Puerto Rico in 1995, and is no longer available.

#### *Controlled Foreign Corporations*

Because of the modification and phase out of the federal tax incentives under Section 936 of the U.S. Code, many corporations previously operating thereunder reorganized their operations in Puerto Rico to become controlled foreign corporations (“CFCs”). A CFC is a corporation that is organized outside the United States and is controlled by United States shareholders. In general, a CFC may defer the payment of federal income taxes on its trade or business income until such income is repatriated to the United States in



the form of dividends or through investments in certain United States properties. The Puerto Rico Office of Industrial Tax Exemption has received notification from numerous corporations that have converted part or all of their operations to CFCs. These include most of the major pharmaceutical, instrument and electronics manufacturing companies in Puerto Rico.

CFCs operate under transfer pricing rules for intangible income that are different from those applicable to United States corporations operating under Section 936 of the U.S. Code (“Section 936 Corporations”). In many cases, they are allowed to attribute a larger share of this income to their Puerto Rico operation but must make a royalty payment “commensurate with income” to their U.S. affiliates. Section 936 Corporations were exempted from Puerto Rico withholding taxes on any cost sharing payments they might have opted to make, but CFCs are subject to a fifteen percent Puerto Rico withholding tax on royalty payments.

Recently, the United States Congress approved legislation that would extend the benefit of Section 199 of the U.S. Code to production activities that take place in Puerto Rico. Section 199 provides a three-point reduction in the federal income tax rate, phased in over five years (from 35% to 31.85% after 2009). This extension applies to the U.S. branch activities located on the island and are not controlled foreign corporations.

SUMMARY OF CERTAIN DEFINITIONS AND PROVISIONS OF THE RESOLUTION

Summary of Certain Definitions

The following terms shall have the following meanings in the Resolution and for all purposes of this Official Statement.

**Account** or **Accounts** shall mean any account or accounts, as the case may be, established and created pursuant to the Resolution, but does not include any escrow or other fund or account established or created pursuant to the provisions of the Resolution relating to the defeasance of Bonds.

**Accrued Payment Obligation** shall mean, for the purposes of transfer from the Revenue Account on each Revenue Account Monthly Disbursement Date, for the related Class of Bonds of a Series and related Parity Obligations or Subordinate Obligations of such Class, and as of any particular Revenue Account Monthly Disbursement Date, (i) the aggregate of the Principal Installments of such Bonds, and principal component of Parity Obligations or Subordinate Obligations, as applicable, due during the next ensuing twelve-month period, plus (ii) the aggregate of the interest due on such Bonds, and interest component of Parity Obligations or Subordinate Obligations, as applicable, due during the next ensuing twelve-month period and, for Adjustable Rate Bonds, based on the Assumed Interest Rate; provided, that in the case of clauses (i) and (ii) above for any Senior Bonds, Subordinate Bonds, Parity Obligations or Subordinate Obligations that have Principal Installments, interest or other scheduled principal or interest components due on a basis more frequently than semi-annually, the amounts described in clauses (i) and (ii) hereof shall be the amounts due during the next ensuing fifteen-month period. The Corporation shall promptly provide, upon written request from the Trustee, written evidence of calculations of Accrued Payment Obligation applicable to any particular Revenue Account Monthly Disbursement Date.

**Act** shall mean Act No. 91 of the Legislative Assembly of Puerto Rico, approved May 13, 2006, as amended and supplemented.

**Adjustable Rate** means a variable, adjustable or similar interest rate or rates to be borne by a Series of Bonds or any one or more maturities within a Series of Bonds, for which the method of computing such variable interest rate is specified in the Supplemental Resolution authorizing such Bonds; provided, that the related Supplemental Resolution shall specify (i) whether a Qualified Hedge is to be applicable to such Adjustable Rate Bonds and, if not, or to the extent not so applicable, a Contractual Maximum Interest Rate, and (ii) the method or methods for determining the Adjustable Rate and the frequency of change thereof; provided further, that the method or methods for determining the Adjustable Rate may include the selection of such rate by an indexing agent or remarketing agent as provided in an agreement between the Corporation and such agent, the utilization of an index or indices as described in the related Supplemental Resolution, the utilization of an auction as described in the related Supplemental Resolution, or such other standard or standards set forth by the Corporation in the related Supplemental Resolution or any combination of the foregoing; and provided further, that the Adjustable Rate may never exceed any Contractual Maximum Interest Rate related thereto or, if none, the Legal Maximum Interest Rate (the “rate cap”), but the excess of interest on any Adjustable Rate Bond calculated at the rate (the “stated rate”) set forth for such Adjustable Rate Bond (without the limitation of the rate cap) over interest on the Adjustable Rate Bond calculated at the rate cap shall constitute a debt of the Corporation owed to the owner of the related Adjustable Rate Bond but solely during periods when the rate cap shall exceed the stated rate.

**Adjustable Rate Bond** means any Bond which bears an Adjustable Rate, provided that a Bond the interest rate on which shall have been fixed for the remainder of the term thereof shall no longer be an Adjustable Rate Bond.

**Ancillary Facility Providers** shall mean, collectively, each Credit Facility Provider, each Liquidity Facility Provider, each Qualified Hedge Provider, and each Standby Purchase Facility Provider.

**Article 5(e) Amount** shall mean, as described in the first sentence of Article 5(e) of the Act, any amount which represents an insufficiency of Pledged Sales Tax receipts to fully pay, when due, principal of and interest on Bonds or to make any other payment related to other obligations incurred hereunder, including payments pursuant to interest rate swap agreements, and also including any application of funds in any Debt Service Reserve Account made for the purpose of meeting any such insufficiency.

**Assumed Interest Rate** shall mean, for Adjustable Rate Bonds, (i) a fixed rate payable by the Corporation under a related Qualified Hedge plus the fixed component of interest on the related Bonds, if any, not included in the payments to be made under the Qualified Hedge by the Qualified Hedge Provider, (ii) for any Qualified Hedge that shall provide for payments from the Corporation that result in a capped rate on the Adjustable Rate Bonds, such capped rate, or (iii) for any Adjustable Rate Bonds that shall not be the subject of a Qualified Hedge, the lesser of the Contractual Maximum Interest Rate established therefor and the Legal Maximum Interest Rate.

**Authorized Officer** shall mean (i) in the case of the Corporation, the Executive Director and any Assistant Executive Director, and when used with reference to any act or document, any other person authorized by resolution of the Corporation to perform such act or sign such document (the Trustee may request that the Corporation deliver an officers' certificate setting forth the names of individuals and/or titles of officers authorized at such time to take specified actions pursuant to the Resolution), and (ii) in the case of the Trustee, any officer assigned to the Northern Municipals Department (or any successor division or unit) of the Trustee located at the Corporate Trust Office, or such other address as the Trustee may designate from time to time by notice to the Corporation, who shall have direct responsibility for the administration of the Resolution, and for the purposes of the eleventh sentence of Section 802 of the Resolution shall also include any other officer of the Trustee to whom any matter is referred because of such officer's knowledge of and familiarity with the particular subject.

**Beneficiaries** shall mean (i) the Owners of Bonds Outstanding, (ii) Credit Facility Providers and Liquidity Facility Providers as to which there are Parity Obligations or Subordinate Obligations outstanding, and (iii) Qualified Hedge Providers as to which there are Qualified Hedges outstanding.

**Bond** or **Bonds** shall mean the initial Series of Bonds, all Series of Bonds issued simultaneously with the initial Series, and any additional Bonds authorized to be issued on a parity therewith pursuant to the Resolution.

**Bondowner** shall mean any person who shall be the registered owner of any Outstanding Bond or Bonds.

**Bond Payment Date** shall mean each date on which Principal Installments of and/or interest on Bonds are due and payable by the Corporation.

**Bond Year** shall mean a twelve-month period commencing on the first day of August in any calendar year and ending on the last day of July in the immediately succeeding calendar year.

**Business Day** shall mean any day other than (i) a Saturday or Sunday, (ii) a day on which the Corporation is authorized to close, or (iii) a day on which banking institutions in San Juan, Puerto Rico, New York, New York, or any city in which the principal office of the Trustee, any Credit Facility Provider (if applicable) or any Liquidity Facility Provider (if applicable) is located are authorized or required by law or executive order to remain closed, or (iii) during any period that a Qualified Hedge is applicable to the Bonds, a day on which commercial banks and foreign exchange markets are not open for business (including dealings in foreign exchange and foreign currency deposits) in the City of New York and do not settle payments.

**Capital Appreciation Bonds** shall mean the Bonds of any Series so designated in a Series Resolution and including all Convertible Capital Appreciation Bonds; provided, however, that the term “Capital Appreciation Bonds” shall only be used with respect to Bonds the interest on which is payable only at maturity (with respect to Convertible Capital Appreciation Bonds, on the related Current Interest Commencement Date rather than at maturity) or earlier redemption or acceleration of maturity in amounts determined by reference to the Compounded Amount of each Bond.

**Capitalized Interest Account** shall mean the Capitalized Interest Account established pursuant to the Resolution.

**Class** shall mean the delineation of Bonds by whether they are Senior Bonds or Subordinate Bonds (or more than one Class of Subordinate Bonds).

**Class Priority** shall mean, at any time that there shall be Subordinate Bonds Outstanding, and with respect to funding of Debt Service Accounts and Debt Service Reserve Accounts pursuant to Section 505, and payment of Bonds upon an Event of Default under Article XI, funding or payment, as applicable, in the order of Senior Bonds and Parity Obligations first until full funding or payment thereof, followed by Subordinate Bonds and Subordinate Obligations of the highest payment priority next until full funding or payment thereof, followed by Subordinate Bonds of lower payment priorities.

**Code** shall mean the Internal Revenue Code of 1986, as amended.

**Commonwealth** shall mean the Commonwealth of Puerto Rico.

**Compounded Amount** shall mean, on any date and with respect to any particular Capital Appreciation Bond or Convertible Capital Appreciation Bond, the initial principal amount at issuance of such Bond plus accretion of principal, based on compounding on each Compounding Date to the date of maturity thereof (with respect to a Capital Appreciation Bond) or to the Current Interest Commencement Date (with respect to a Convertible Capital Appreciation Bond) at the same interest rate as shall produce a compound amount on such date of maturity or Current Interest Commencement Date, as applicable, equal to the principal amount thereof on such date; provided, that Compounded Amount on any day which is not a Compounding Date shall be determined on the assumption that the Compounded Amount accrues in equal daily amounts between Compounding Dates.

**Compounding Date** shall mean the date on which interest on a Capital Appreciation Bond or Convertible Capital Appreciation Bond is compounded and added to principal in the form of Compounded Amount, as set forth in the related Series Resolution.

**Contractual Maximum Interest Rate** shall mean, with respect to any particular Adjustable Rate Bond, a numerical rate of interest, which shall be set forth in the Supplemental Resolution authorizing such Bond, that as a matter of contract shall be the maximum rate at which such Bond may bear interest at any time; provided, that the Contractual Maximum Interest Rate may not exceed the Legal Maximum Interest Rate.

**Convertible Capital Appreciation Bonds** shall mean Bonds which, on or prior to the Current Interest Commencement Date, have the characteristics of Capital Appreciation Bonds and, after the Current Interest Commencement Date, have the characteristics of Current Interest Bonds, in each case with such further terms and conditions as may be designated therefor in the Supplemental Resolution authorizing such Bonds.

**Corporation** shall mean the Puerto Rico Sales Tax Financing Corporation, an independent governmental instrumentality of the Commonwealth of Puerto Rico, and its successors and permitted assigns, organized pursuant to the Act.

**Costs of Issuance** shall mean any item of expense directly or indirectly payable or reimbursable by the Corporation and related to the authorization, sale, or issuance of Bonds, including, but not limited to, capitalized interest, underwriting fees, underwriters' or original issue discount and fees and expenses of professional consultants and fiduciaries.

**Costs of Issuance Account** shall mean the Costs of Issuance Account established pursuant to the Resolution.

**Credit Facility** shall mean each irrevocable letter of credit, bond insurance policy, surety bond, loan agreement, or other agreement, facility or insurance or guaranty arrangement issued or extended by a bank, a trust company, a national banking association, an organization subject to registration with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956 or any successor provisions of law, a federal branch pursuant to the International Banking Act of 1978 or any successor provisions of law, a savings bank, a savings and loan association, a Federal Home Loan Bank, a corporation, an insurance company or association chartered or organized under the laws of any state of the United States of America, the Government National Mortgage Association or any successor thereto, Fannie Mae, the Federal Home Loan Mortgage Corporation or any successor thereto, or any other federal or State agency or instrumentality approved by the Corporation, pursuant to which the Corporation is entitled to obtain moneys to pay, in the Currency in which the bonds of such Series are payable, the principal or Redemption Price of Bonds due in accordance with their terms plus accrued interest thereon to the date of payment thereof in accordance herewith and with the Supplemental Resolution authorizing such Bonds, whether or not the Corporation is in default under the Resolution; provided, that use of a Credit Facility shall not result, at the time of delivery of the Credit Facility, in a reduction in the rating of any Bonds Outstanding; and provided further, that a substitute Credit Facility may be obtained from time to time (i) which shall contain the same material terms as set forth in the Credit Facility for which substitution is made, and (ii) will not, in and of itself, result in a rating of the related Bonds lower than those which then prevailed.

**Credit Facility Provider** shall mean the Person that has executed a Credit Facility with the Corporation, or otherwise has provided a Credit Facility at the request of the Corporation, for the benefit of any of the Bonds.

**Currency** shall mean Dollars or Foreign Currency or Currency Unit.

**Currency Unit** shall mean a composite currency or currency unit the value of which is determined by reference to the value of the currencies of any group of countries.

**Current Interest Bonds** shall mean Bonds that bear interest which is payable semiannually (except for the initial and/or final interest rate periods) or more often.

**Current Interest Commencement Date** shall mean the date established prior to the issuance of each Series of Convertible Capital Appreciation Bonds, at which time the semiannual compounding of interest ceases and on and after such date interest is payable currently on the Compounded Amounts on the next ensuing interest payment dates.

**Debt Service Account** shall mean the Account by that name established by the Resolution.

**Debt Service Reserve Account** shall mean the Account by that name established by the Resolution.

**Debt Service Reserve Requirement** shall be determined as of the date of authentication and delivery of each Series of Bonds and from time to time thereafter as may be required or permitted by the Resolution and shall mean, as of any date of calculation, an amount equal to the aggregate of the Debt Service Reserve Requirements established in Series Resolutions for each Series of Bonds Outstanding.

**Dedicated Sales Tax** shall mean the portion of the sales tax imposed in the Commonwealth which is required to be deposited in the Dedicated Sales Tax Fund created by Article 2 of the Act, and the right to receive the same, as provided for by the Act, and any additional share of such sales tax, and the right to receive the same, which by law is to be deposited in the Dedicated Sales Tax Fund.

**Defeasance Obligations** shall mean any of the following which are not callable or redeemable at the option of the issuer thereof, if and to the extent the same are at the time legal for the investment of the Corporation's funds:

- (i) Government Obligations;
- (ii) Defeased Municipal Obligations;
- (iii) any other investment designated in a Supplemental Resolution as a Defeasance Obligation for purposes of defeasing the Bonds authorized by such Supplemental Resolution or Bonds authorized thereafter; provided that each Rating Agency has confirmed in writing to the Trustee that the use of such other investment will not, by itself, result in the withdrawal, suspension or downgrade of any rating issued by such Rating Agency with respect to any such Bonds to be defeased;
- (iv) an obligation of Fannie Mae, the Federal Home Loan Mortgage Corporation or any other government sponsored enterprise or federal agency or instrumentality rated in the highest Ratings Category by each Rating Agency, if and to the extent approved by the Corporation;
- (v) certificates, depositary receipts or other instruments which evidence a direct ownership interest in obligations described in clauses (i) through (iv) above or in any specific interest or principal payments due in respect thereof; provided,

however, that the custodian of such obligations or specific interest or principal payments shall be a bank or trust company organized under the laws of the United States of America or of any state or territory thereof or of the District of Columbia, with a combined capital stock, surplus and undivided profits of at least \$50,000,000 or the custodian is appointed by or on behalf of the United States of America; and provided further, however, that except as may be otherwise required by law, such custodian shall be obligated to pay to the holders of such certificates, depositary receipts or other instruments the full amount received by such custodian in respect of such obligations or specific payments and shall not be permitted to make any deduction therefrom; or

(vi) a share or interest in a mutual fund, partnership or other fund wholly comprised of obligations described in clauses (i) through (v) above.

**Defeased Municipal Obligations** shall mean any bonds or other obligations of any state or territory of the United States of America, of the Commonwealth, or of any agency, instrumentality or local governmental unit of any such state or territory or Commonwealth which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice; and

(i) which are rated, based on an irrevocable escrow account or fund (the “escrow”), in the highest rating category of any Rating Agency; or

(ii) (a) which are fully secured as to principal, interest and redemption premium, if any, by an escrow consisting only of cash or Government Obligations, which escrow may be applied only to the payment of such principal and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (b) which escrow is sufficient, as verified by a nationally recognized independent certified public accountant, or other nationally recognized verification agent, to pay principal and interest and redemption premium, if any, on the bonds or other obligations described in this paragraph on the maturity date or dates specified in the irrevocable instructions referred to above, as appropriate.

**Dollar** shall mean a dollar or other equivalent unit in such coin or currency of the United States as at the time of payment is legal tender for the payment of public and private debts.

**Event of Default** shall have the meaning specified in the Resolution.

**Financing Costs** shall mean, with respect to any Bonds, all costs of issuance and any other fees, discounts, expenses and costs related to issuing, securing and marketing Bonds, including, without limitation, redemption premiums and other costs of redemption.

**Fiscal Year** shall mean the fiscal year of the Commonwealth Government beginning July 1 of each calendar year.

**Fitch** shall mean Fitch Ratings, and its successors and assigns.

**Fixed Tender Bond** shall mean any Bond, not constituting an Adjustable Rate Bond, which by its terms must be tendered by the Owner thereof for purchase by or for the account of the Corporation prior to the stated maturity thereof or for purchase thereof.

**Foreign Currency** shall mean a currency issued by the government of any country other than the United States or a composite currency or currency unit the value of which is determined by reference to the values of the currencies of any group of countries.

**Fund or Funds** shall mean the Repayment Project Fund and any fund or funds, as the case may be, established and created pursuant to the Resolution, but does not include any escrow or other fund or account established or created pursuant to the provisions of the Resolution relating to the defeasance of Bonds.

**GDB** shall mean Government Development Bank for Puerto Rico, and its successor and permitted assigns.

**Government Obligations** shall mean direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States of America and entitled to the full faith and credit thereof.

**Interest Subaccount** shall mean the Interest Subaccount established in the Debt Service Account by the Resolution.

**Investment Obligations** shall mean and include any of the following securities, if and to the extent the same are at the time legal for investment of the Corporation's funds:

- (i) Defeasance Obligations;
- (ii) Defeased Municipal Obligations;
- (iii) public housing bonds issued by public agencies or municipalities and fully secured as to the payment of both principal and interest by a pledge of annual contributions under an annual contributions contract or contracts with the United States of America; temporary notes, preliminary loan notes or project notes issued by public agencies or municipalities, in each case fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States of America; or obligations issued by any state or any public agencies or municipalities which are rated in the highest rating category by a nationally recognized bond rating agency;
- (iv) direct and general obligations of any state of the United States to the payment of the principal of and interest on which the full faith and credit of such state is pledged which are rated in either of the two highest rating categories by a nationally recognized bond rating agency;
- (v) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, Fannie Mae, the Federal Home Loan Mortgage Corporation, or the Federal Farm Credit System;
- (vi) prime commercial paper of a corporation incorporated under the laws of any state of the United States of America, rated "P-1", "A-1" or "F1" by Moody's, Standard & Poor's or Fitch, respectively;
- (vii) shares of a diversified open-end management investment company as defined in the Investment Company Act of 1940, which is a money market fund, which has been rated "A" or better by Moody's, Standard & Poor's or Fitch or



money market accounts of the Trustee or any bank or trust company organized under the laws of the United States or any state thereof, which has a combined capital and surplus of not less than \$50,000,000;

(viii) bank deposits evidenced by certificates of deposit issued by banks (which may include the Trustee) which are members of the Federal Deposit Insurance Corporation, provided that such time deposits are fully secured by obligations described in clause (i) or (ii) above, which such obligations at all times have a market value (exclusive of accrued interest) at least equal to such bank deposits so secured, including interest;

(ix) repurchase agreements relating to securities of the type specified in clauses (i) and (ii) above, provided that such securities in an amount at least equal to the face value of such agreements shall be delivered as security for such agreements to the account of the Trustee to be held therein during the term of the agreements;

(x) investment agreements, secured or unsecured, with any institutions whose debt securities are rated at least "AA" (or equivalent rating of short-term obligations if the investment is for a period not exceeding one year) by Standard & Poor's or equivalent Rating by Moody's, Fitch or other Rating Agency; and

(xi) any other obligations conforming to the Corporation's guidelines for investment, so long as such obligations are rated at least in the two highest Rating Categories of each of the Rating Agencies and are approved by the applicable Credit Facility Provider.

**Legal Maximum Interest Rate** shall mean the highest rate of interest or highest true interest cost that by law may be borne by any Bonds; at present, 12% per annum.

**Liquidity Facility** shall mean, if and to the extent constituting an Ancillary Bond Facility, an irrevocable letter of credit, surety bond, loan agreement, Standby Purchase Agreement, line of credit or other agreement or arrangement issued or extended by a bank, a trust company, a national banking association, an organization subject to registration with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956 or any successor provisions of law, a federal branch pursuant to the International Banking Act of 1978 or any successor provisions of law, a savings bank, a savings and loan association, a Federal Home Loan Bank, an insurance company or association chartered or organized under the laws of any state of the United States of America, the Government National Mortgage Association or any successor thereto, Fannie Mae or any successor thereto, the Federal Home Loan Mortgage Corporation or any successor thereto, or any other government sponsored enterprise or federal or State agency or instrumentality approved by the Corporation, pursuant to which the Corporation is entitled to obtain moneys upon the terms and conditions contained therein for the purchase or redemption of Bonds tendered for purchase or redemption in accordance with the terms hereof and of the Supplemental Resolution authorizing such Bond; provided, that the use of the Liquidity Facility shall not result, at the time of delivery of the Liquidity Facility, in a reduction in the rating of any Bonds Outstanding; and provided further that a substitute Liquidity Facility may be obtained from time to time (i) which shall contain the same material terms as set forth in the Liquidity Facility for which substitution is made, and (ii) will not, in and of itself, result in a rating of the related Bonds lower than those which then prevailed.

**Liquidity Facility Provider** shall mean the Person that has executed a Liquidity Facility with the Corporation, or otherwise has provided a Liquidity Facility at the request of the Corporation, for the benefit of any of the Bonds.

**Maturity Amount** shall mean the Compounded Amount of any Capital Appreciation Bond as of the stated maturity thereof.

**Moody's** shall mean Moody's Investors Service, and its successors and assigns.

**Operating Cap** shall mean \$200,000 in the Fiscal Year ending June 30, 2008 and, in each following Fiscal Year, the prior year's Operating Cap inflated by 2%.

**Operating Expenses** shall mean the reasonable operating and administrative expenses of the Corporation (including, without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on Bonds, insurance premiums, deductibles and retention payments, and costs of meetings or other required activities of the Corporation), legal fees and expenses of the Corporation, fee and expenses incurred for professional consultants and fiduciaries, including the Trustee, and regularly scheduled fees payable under each Credit Facility and Liquidity Facility. Whenever a requisition for "Operating Expenses" from the Revenue Account shall be made pursuant to Section 505.1 FIRST of the Resolution, a certificate of an Authorized Officer of the Corporation, stating that such amount constitutes "Operating Expense" as defined in the Resolution, shall be delivered to the Trustee.

**Opinion of Bond Counsel** shall mean an opinion signed by Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, or any other attorney or firm of attorneys of recognized standing in the field of law relating to municipal bonds selected by the Corporation and satisfactory to the Trustee.

**Opinion of Counsel** shall mean an opinion signed by an attorney or firm of attorneys of recognized standing (who may be counsel to the Corporation) selected by the Corporation.

**Option Bond** shall mean any Bond which by its terms may be tendered by and at the option of the Owner thereof for redemption by the Corporation prior to the stated maturity thereof or for purchase thereof, or the maturity of which may be extended by and at the option of the Owner thereof.

**Original Principal Amount** shall mean the Compounded Amount of any Capital Appreciation Bond as of the date of original issuance, as set forth in the applicable Series Resolution.

**Outstanding**, when used with reference to the Bonds as a whole or the Bonds of a Series, shall mean, as of any date, the Bonds or Bonds of such Series, as the case may be, theretofore or thereupon being delivered and issued under the provisions of the Resolution, except:

(i) any Bonds canceled by or surrendered for cancellation to the Trustee at or prior to such date;

(ii) Bonds for the payment or redemption of which moneys or Defeasance Obligations equal to the principal amount or Redemption Price thereof, as the case may be, with interest to the date of maturity or redemption date, shall be held by the Trustee in trust (whether at or prior to the maturity or redemption date), provided that if such Bonds are to be redeemed, notice of such redemption shall have been given as provided in Article IV or provision shall have been made for the giving of such notice, and provided further that if such notice is conditional, it is no longer subject to rescission;

(iii) Bonds deemed to have been paid as provided in the Section of the Resolution relating to defeasance of Bonds;

(iv) Bonds in lieu of or in substitution for which other Bonds shall have been authenticated and delivered pursuant to the Resolution;

(v) Option Bonds tendered or deemed tendered in accordance with the provisions of the Supplemental Resolution authorizing such Bonds on the applicable tender date, if the purchase price thereof and interest thereon shall have been paid or amounts are available and set aside for such payment as provided in such Supplemental Resolution, except to the extent such tendered Option Bonds are held by the Corporation or a Credit Facility Provider or a Liquidity Facility Provider and/or thereafter may be resold pursuant to the terms thereof and of such Supplemental Resolution; and

(vi) as may be provided with respect to such Bonds by the Supplemental Resolution authorizing such Bonds;

provided, however, that in determining whether the Owners of the requisite principal amount of Outstanding Bonds have given any request, demand, authorization, direction, notice, consent or waiver, Bonds owned by the Corporation shall be disregarded and deemed not to be Outstanding, except that, in determining whether the Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent or waiver, only Bonds which an Authorized Officer of the Trustee actually knows to be so owned shall be so disregarded. Bonds so owned which have been pledged in good faith may be regarded as Outstanding if the pledgee establishes the pledgee's right so to act with respect to such Bonds and that the pledgee is not the Corporation.

In determining whether Owners of the requisite principal amount of Outstanding Bonds have given any requisite demand, authorization, direction, notice, consent or waiver hereunder, the principal amount of a Convertible Capital Appreciation Bond or a Capital Appreciation Bond that shall be deemed Outstanding for such purposes shall be the Compounded Amount thereof except as otherwise provided in the Resolution.

**Owner or Owner of Bonds** shall mean Bondowner.

**Parity Hedge Obligations** shall mean, as allocated to each Series of Senior Bonds pursuant to the terms of the related Series Resolution, fixed and scheduled payments by the Corporation under Qualified Hedges. Parity Hedge Obligations shall not include, among other things, any costs, indemnities, termination payments or similar non-recurring amounts, or any amortization of any thereof.

**Parity Obligations** shall mean, collectively, all Parity Reimbursement Obligations and Parity Hedge Obligations.

**Parity Reimbursement Obligations** shall mean, as allocated to each Series of Senior Bonds pursuant to the terms of the related Series Resolution, fixed and scheduled payments due from the Corporation to any Credit Facility Provider, as provided by Section 205 of the Resolution and set forth or provided for in any Supplemental Resolution. Parity Reimbursement Obligations shall include, among other things, reimbursements of direct-pay letters of credit to be drawn on each principal and/or interest payment date.

**Person** or **Persons** shall mean an individual, partnership, limited liability partnership, corporation, limited liability corporation, trust or unincorporated organization and a government or agency or political subdivision or branch thereof.

**Pledged Property** shall mean the following, collectively, except as otherwise may be provided with respect to a Series of Bonds by the Supplemental Resolution authorizing such Bonds:

1. All Revenues.
2. All right, title and interest of the Corporation in and to Revenues, and all rights to receive the same.
3. The Funds, Accounts (other than the Costs of Issuance Account, Bond Proceeds Account and Rebate Account) and Subaccounts (other than Subaccounts in the Costs of Issuance Account or Rebate Account) held by the Trustee, and moneys and securities and, in the case of the Debt Service Reserve Account, Reserve Account Cash Equivalents, from time to time held under the terms of the Resolution, subject to the application thereof as provided in the Resolution.
4. Any and all other rights and property of every kind and nature from time to time hereafter pledged by the Corporation to the Trustee as and for additional security for the Bonds and Parity Obligations.
5. Any an all cash and non-cash proceeds, products, offspring, rents, and profits from any of the Pledged Property mentioned described in paragraphs (1) through (4) above, including, without limitation, those from the sale, exchange, transfer, collection, loss, damage, disposition, substitution or replacement of any of the foregoing.

**Pledged Sales Tax** shall mean the portion of the Dedicated Sales Tax described in subparagraph (a) of Article 3 and subparagraph (e) of Article 5 of the Act.

**Pledged Sales Tax Base Amount** means, for each Fiscal Year, the amount of \$185,000,000 for the Fiscal Year beginning July 1, 2007, as increased in each subsequent Fiscal Year by four percent (4%) of the prior Fiscal Year's Pledged Sales Tax Base Amount, subject to modifications made thereto after the date hereof, if any, by the Legislature of Puerto Rico.

**Principal Installment** shall mean, as of any date with respect to any Series, so long as any Bonds thereof are Outstanding, the sum of (i) the principal amount and Compounded Amount (to the extent applicable) of Bonds of such Series (including the principal amount of Option Bonds tendered for payment and not purchased) due (or so tendered for payment and not purchased) on such date for which no Sinking Fund Installments have been established, and (ii) the unsatisfied balance (determined as provided in the Resolution) of any Sinking Fund Installments due on such date for Bonds of such Series, together with the premiums, if any, payable upon the redemption of such Bonds by application of such Sinking Fund Installments.

**Principal Subaccount** shall mean the Principal Subaccount established in the Debt Service Account by the Resolution.

**Qualified Hedge** shall mean, if and to the extent from time to time permitted by law, with respect to Bonds, (i) any financial arrangement (a) which is entered into by the Corporation with an entity that is a Qualified Hedge Provider at the time the arrangement is entered into, (b) which is a cap,

floor or collar, forward rate, future rate, swap (such swap may be based on an amount equal either to the principal amount of such Bonds as may be designated or a notional principal amount relating to all or a portion of the principal amount of such Bonds), asset, index, Currency, price or market-linked transaction or agreement, other exchange or rate protection transaction agreement, other similar transaction (however designated), or any combination thereof, or any option with respect to any of the foregoing, executed by the Corporation, and (c) which has been designated as a Qualified Hedge with respect to such Bonds in a written determination signed by an Authorized Officer of the Corporation and delivered to the Trustee, and (ii) any letter of credit, line of credit, policy of insurance, surety bond, guarantee or similar instrument securing the obligations of the Corporation under any financial arrangement described in clause (i) above; provided, that with respect to any variable rate Bonds that are to be covered by a Qualified Hedge constituting an interest rate exchange agreement, scheduled amounts payable by the Qualified Hedge Provider under such Qualified Hedge shall exactly match the scheduled interest payable on the Bonds covered by the Qualified Hedge, without “basis risk” and without allowance for adjustment thereto except to match any adjustment in the scheduled interest payable on such Bonds.

**Qualified Hedge Provider** means (i) each Series 2007 Qualified Hedge Provider, (ii) a Person whose long term obligations, other unsecured long term obligations, financial program rating, counterparty rating, or claims paying ability are rated, or whose payment obligations under an interest rate exchange agreement are guaranteed by an entity whose long term debt obligations, other unsecured long term obligations, financial program rating, counterparty rating, or claims paying ability, are rated, at the time of the execution of such Qualified Hedge, either (a) at least as high as the third highest Rating Category of each Rating Agency, but in no event lower than any Rating Category designated by any such Rating Agency for the Bonds, subject to such Qualified Hedge (without reference to bond insurance, if any), or (b) any such lower Rating Categories which each such Rating Agency indicates in writing to the Corporation and the Trustee will not, by itself, result in a reduction or withdrawal of its Rating (without reference to bond insurance, if any) on the Outstanding Bonds, and (iii) a Person whose payment obligations under an interest rate exchange agreement are subject to collateralization requirements that, as evidenced in writing to the Corporation and the Trustee by each Rating Agency, will not, by itself, result in a reduction or withdrawal of its Rating (without reference to bond insurance, if any) on the Outstanding Bonds.

**Rating Agency** shall mean each nationally recognized statistical rating organization then maintaining a rating on the Bonds at the request of the Corporation.

**Rating Category** shall mean one of the generic rating categories of any Rating Agency without regard to any refinement or gradation of such rating by a numerical modifier or otherwise.

**Rebate Account** shall mean the Account by that name established by the Resolution.

**Rebate Amount** shall mean with respect to the Bonds, the amount computed as described in the Tax Certificate.

**Record Date** shall mean, with respect to each payment of principal and premium of and interest on each Bond, the date specified as the “record date” therefor in the Supplemental Resolution authorizing such Bond.

**Redemption Account** shall mean the Account by that name established by the Resolution.

**Redemption Price** shall mean, when used with respect to a Bond (other than a Convertible Capital Appreciation Bond or a Capital Appreciation Bond), or a portion thereof to be

redeemed, the principal amount of such Bond or such portion thereof plus the applicable premium, if any, payable upon redemption thereof, pursuant to the Resolution and the applicable Supplemental Resolution, but, when used with respect to a Convertible Capital Appreciation Bond or a Capital Appreciation Bond, “Redemption Price” shall mean the Compounded Amount on the date of redemption of such Bond or portion thereof plus the applicable premium, if any.

**Refunding Bonds** shall mean all Bonds authenticated and delivered on original issuance pursuant to the Resolution or thereafter authenticated and delivered in lieu of or in substitution for any such Bond pursuant to the Resolution and the applicable Series Resolution.

**Repayment Project** shall mean the repayment or refinancing or defeasance of all or any portion of the “extraconstitutional debt” of the Commonwealth outstanding as of June 30, 2006, as contemplated by the Act, and any similar repayment or refinancing program authorized by law which is to be supported by the Pledged Sales Tax.

**Reserve Account Cash Equivalent** shall mean a letter of credit, insurance policy, surety, guaranty or other security arrangement provided to the Trustee as a substitute for the deposit of cash and/or Investment Securities, or another Reserve Account Cash Equivalent, in the Debt Service Reserve Account pursuant to the Resolution. Each such arrangement shall be provided by a Person which has received a rating of its claims paying ability from each Rating Agency at least equal to the then existing rating on the Bonds or whose unsecured long-term debt securities are rated by each Rating Agency at least equal to the then existing rating on the Bonds (or the highest short-term rating if the Reserve Account Cash Equivalent has a remaining term at the time of acquisition not exceeding one year); provided, however, that a Reserve Account Cash Equivalent may be provided by a Person who has received a rating of its claims paying ability which is lower than that set forth above or whose unsecured long-term (or short-term) debt securities are rated lower than that set forth above, so long as the providing of such Reserve Account Cash Equivalent does not, as of the date it is provided, in and of itself, result in the reduction or withdrawal of the then existing rating assigned to any of the Bonds by any of the Rating Agencies.

**Resolution** shall mean the Puerto Rico Sales Tax Financing Corporation Sales Tax Revenue Bond Resolution, as from time to time amended or supplemented by Supplemental Resolutions.

**Revenue Account** shall mean the Account by that name established by the Resolution.

**Revenue Account Monthly Disbursement Date** shall mean the last Business Day of each calendar month.

**Revenues** shall mean the following, collectively, except as otherwise may be provided with respect to a Series of Bonds by the Supplemental Resolution authorizing such Bonds:

1. All Pledged Sales Tax received by the Corporation or the Trustee.
2. With respect to any particular Bonds, the proceeds of any draw on or payment under any Credit Facility which is intended for the payment of such Bonds, but only for purposes of such payment and not for purposes of the additional Bonds test or other purposes of the Resolution.

3. Any amounts received by the Corporation pursuant to a Qualified Hedge after giving effect to any netting of amounts payable by the parties thereunder.

4. Income and interest earned and gains realized in excess of losses suffered by any Fund, Account (other than the Costs of Issuance Account, Bond Proceeds Account and Rebate Account) or Subaccount (other than any Subaccount in the Costs of Issuance Account, Bond Proceeds Account or Rebate Account) held by the Trustee under the terms of the Resolution.

5. Any other revenues, fees, charges, surcharges, rents, proceeds or other income and receipts received by or on behalf of the Corporation or by the Trustee, lawfully available for the purposes of the Resolution and deposited by or on behalf of the Corporation or by the Trustee in any Fund, Account (other than the Costs of Issuance Account and Rebate Account) or Subaccount (other than any Subaccount in the Costs of Issuance Account or Rebate Account) held by the Trustee under the terms of the Resolution, including any available funds not constituting Pledged Sales Tax appropriated by the Legislature of Puerto Rico for the purposes stated in subparagraph (a) of Article 5 of the Act and the second sentence of subparagraph (e) of Article 5 of the Act, subject to the provisions of Sections 1201 and 1203 of the Resolution.

**Security Agreement** means the Security Agreement dated as of July 31, 2007 between the Corporation and the Trustee.

**Senior Bonds** means the Series 2008A Bonds of the Series designated as “Series 2008A”, and any Bonds of a Class the priority of payment of which under the Resolution is equal with that of the Series 2007A Bonds, the Series 2007B Bonds, and the Series 2007C Bonds.

**Serial Bonds** shall mean Bonds which have no Sinking Fund Installments.

**Series** shall mean all of the Bonds authenticated and delivered on original issuance identified pursuant to the Supplemental Resolution as a separate series of Bonds, and any Bonds thereafter authenticated and delivered in lieu of or in substitution therefor pursuant to the Resolution, regardless of variations in maturities, principal amount, interest rate or other provisions.

**Series 2008A Bonds** shall mean the Corporation’s Sales Tax Revenue Bonds, Series 2008A.

**Series 2008A Qualified Hedge Provider** shall mean the Qualified Hedge Provider or Providers named in the Series Resolution applicable to the Series 2008A Bonds.

**Series Resolution** shall mean a Supplemental Resolution authorizing or providing for the issuance of a Series of Bonds pursuant to Section 202(2) of the Resolution.

**Sinking Fund Installment** shall mean, when used with respect to any Series of Bonds, the amount of principal or Compounded Amount, as the case may be, due prior to maturity on Bonds of a given maturity on any particular due date as specified in the Supplemental Resolution pursuant to which such Series was issued.

**Standard & Poor’s** shall mean Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc., and its successors and assigns.

**Standby Purchase Agreement** means, if and to the extent constituting an Ancillary Bond Facility, an agreement by and between the Corporation and another person pursuant to which such person is obligated to purchase Option Bonds or Fixed Tender Bonds tendered for purchase.

**Subaccount** or **Subaccounts** shall mean any subaccount or subaccounts, as the case may be, established or created pursuant to the Resolution, including but not limited to any subaccount of a subaccount, that does not include any escrow or other fund or account established or created pursuant to the provisions of the Resolution relating to the defeasance of Bonds.

**Subordinate Bonds** shall mean Bonds of a Series, and consisting of one or more Classes, the priority of payment of which under the Resolution is subordinate to payment of the Senior Bonds (and which are further subject to the terms of priority of payment among the several Classes, if any, of Subordinate Bonds).

**Subordinate Obligations** shall mean, as allocated to each Series of Bonds by Class pursuant to the terms of the related Series Resolution, payment obligations to Persons of the type that otherwise would be classified under the Resolution as Parity Obligations but are subject instead, pursuant to the provisions of the applicable Series Resolutions, to subordination to Parity Obligations under the Resolution on the terms and conditions set forth in such Series Resolutions.

**Supplemental Resolution** shall mean any resolution supplemental to or amendatory of the Resolution or any Supplemental Resolution, adopted by the Corporation in accordance with the Resolution.

**Taxable Bonds** shall mean Bonds of a Series which are not Tax Exempt Bonds.

**Tax Certificate** shall mean the document executed by the Corporation with respect to each Series of Bonds containing representations and certifications to support the exclusion of the interest on such Bonds under the Code.

**Tax Exempt Bonds** shall mean Bonds of a Series the interest on which, in the opinion of Bond Counsel, on the date of original issuance thereof, is excluded from gross income for federal income tax purposes.

**Term Bonds** shall mean Bonds having a single stated maturity date for which Sinking Fund Installments are specified in a Supplemental Resolution.

**Trustee** shall mean the bank, trust company or national banking association appointed pursuant to the Resolution to act as trustee hereunder, and its successor or successors and any other bank, trust company or national banking association which may at any time be substituted in its place pursuant to the provisions of the Resolution.



## **Summary of Certain Provisions of the Resolution**

*The following is a general summary of certain provisions of the Resolution as presently in effect. The summary does not purport to be comprehensive or definitive and is subject to all of the terms and provisions of the Resolution, to which reference is hereby made.*

### **Resolution to Constitute Contract (Section 103)**

The Resolution shall be deemed to be and shall constitute a contract between the Corporation, the Owners from time to time of the Bonds and the Credit Facility Providers; and the pledge made in the Resolution and the covenants and agreements therein set forth to be performed on behalf of the Corporation shall be for the equal benefit, protection and security of the Owners of any and all of the Bonds and the Credit Facility Providers, all of which, regardless of the time or times of their authentication and delivery or maturity, shall be of equal rank without preference, priority or distinction of any of the Bonds and Credit Facility Providers over any other thereof, except as expressly provided in or permitted by the Resolution.

### **Authorization of Bonds (Section 201)**

The Resolution creates, in the manner and to the extent provided therein, a continuing pledge of and lien on Pledged Property to secure the full and final payment of the principal of and premium, if any, and interest on, all of the Bonds issued pursuant to the Resolution. The Bonds shall be special obligations of the Corporation payable from the Pledged Property without recourse against other assets of the Corporation. The Commonwealth shall not be liable on the Bonds. No Bond shall constitute a debt of the Commonwealth within the meaning of any constitutional provision, or a pledge of the faith and credit of the Commonwealth or of the taxing power of the Commonwealth, and the Commonwealth shall not be liable to make any payments thereon, nor shall any Bond be payable out of any funds or assets other than the Dedicated Sales Tax Fund and other funds and assets of or available to the Corporation and pledged therefor.

### **Special Provisions for Refunding Bonds (Section 203)**

Bonds of one or more Series may be authenticated and delivered upon original issuance, subject to the provisions and limitations of the Resolution, for the purposes of creating economic savings, restructuring debt service, modifying Resolution covenants, and providing for more favorable debt terms, or any of the foregoing or any other valid corporate purpose of the Corporation. Each Supplemental Resolution authorizing a Series of Refunding Bonds shall set forth that the purposes for which such Series is issued include the payment or redemption of all or any part of the Bonds of any one or more Series then Outstanding.

The Refunding Bonds of such Series shall be authenticated and delivered by the Trustee upon receipt by the Trustee (in addition to the general provisions set forth in the Resolution for the issuance of Bonds) of:

- (i) irrevocable instructions to the Trustee to give due notice of the payment or redemption of all the Bonds so to be refunded on a payment or redemption date specified in such instructions and the payment or redemption dates, if any, upon which such Bonds are to be paid or redeemed;
- (ii) if the Bonds of a Series to be refunded are to be paid or redeemed subsequent to the forty-fifth day next succeeding the date of authentication,

irrevocable instructions to the Trustee, to provide notice in the manner provided in the Section entitled “Defeasance” below with respect to the payment of such Bonds pursuant to such Section;

(iii) either (A) moneys or (B) Defeasance Securities as shall be necessary to comply with the provisions of the second paragraph of the Section entitled “Defeasance,” which moneys and Defeasance Securities shall be held in trust and used only as provided in said paragraph.

(iv) a certificate of an independent certified public accountant, or other nationally recognized verification agent, that the amounts described in paragraph (iii) above are sufficient to pay or redeem all of the Bonds to be refunded;

Refunding Bonds may be issued upon compliance with the Section entitled “Issuance of Additional Bonds,” below, in lieu of compliance with the second paragraph of this Section.

### **Credit and Liquidity Facilities; Rights of Credit Facility Providers (Section 205)**

In connection with any Bonds, the Corporation may obtain or cause to be obtained one or more Credit Facilities or Liquidity Facilities and agree with the Credit Facility Provider or Liquidity Facility Provider to reimburse such provider directly for amounts paid under the terms of such Credit Facility or Liquidity Facility, together with interest thereon; provided, however, that no obligation to reimburse a Credit Facility Provider or Liquidity Facility Provider shall be created, for purposes of the Resolution, until amounts are paid under such Credit Facility or Liquidity Facility.

Any Supplemental Resolution may provide that (i) so long as a Credit Facility providing security is in full force and effect, and payment on the Credit Facility is not in default and the Credit Facility Provider is qualified to do business in the Commonwealth, the Credit Facility Provider shall be deemed to be the sole Owner of the Outstanding Bonds the payment of which such Credit Facility secures when the approval, consent or action of the Owners of such Bonds is required or may be exercised under the Resolution, or, in the alternative, that the approval, consent or action of the Credit Facility Provider shall be required in addition to the approval, consent or action of the applicable percentage of the Owners of Outstanding Bonds required by the Section entitled “Powers of Amendment” below and following an Event of Default, provided that no such approval, consent or action of a Credit Facility Provider may be made or taken without the approval, consent or action of the Owner of each Bond affected if such approval, consent or action of such Owner otherwise would be required by the second sentence of the Section entitled “Powers of Amendment,” and (ii) in the event that the principal, Sinking Fund Installments, if any, and Redemption Price, if applicable, and interest due on any Outstanding Bonds shall be paid under the provisions of a Credit Facility, all covenants, agreements and other obligations of the Corporation to the Owners of such Bonds shall continue to exist and such Bonds shall be deemed to remain Outstanding, and such Credit Facility Provider shall be subrogated to the rights of such Owners in accordance with the terms of such Credit Facility.

### **Qualified Hedges (Section 206)**

The Corporation may enter into one or more Qualified Hedges in connection with any Bonds (i) at the time of issuance of such Bonds, (ii) prior to the issuance of such Bonds, in anticipation of the issuance thereof, provided such Bonds have been authorized by the Corporation and payments by the Corporation under the Qualified Hedges do not commence until the date such Bonds are expected to be issued or (iii) after the issuance of such Bonds.

### **Privilege of Redemption and Redemption Price (Section 401)**

Bonds subject to redemption prior to maturity pursuant to a Supplemental Resolution shall be redeemable, upon notice as provided in the Resolution, at such times, at such Redemption Prices, in such Currencies and upon such terms in addition to and consistent with the terms contained in the Resolution as may be specified in the Supplemental Resolution authorizing such Series.

### **Redemption at the Election of the Corporation (Section 402)**

In the case of any redemption of Bonds otherwise than as provided in the Section entitled “Redemption out of Sinking Fund Installments” below, the Corporation shall give written notice to the Trustee of its election so to redeem, of the redemption date, of the “CUSIP,” “ISIN” or other similar numbers (provided, however, that the Corporation and the Trustee shall not be liable for the correctness of such numbers as contained in such notice), of the Series, and of the aggregate principal amount (or Compounded Amount, if applicable) of the Bonds of each maturity and interest rate of such Series to be redeemed which principal amount (or Compounded Amount, if applicable) shall be determined by the Corporation in its sole discretion subject to any limitations with respect thereto contained in any Supplemental Resolution and of the moneys to be applied to the payment of the Redemption Price. Such notice shall be given at least thirty (30) days prior to the redemption date or such shorter period as shall be acceptable to the Trustee. In the event notice of redemption shall have been given as provided in the Resolution, except to the extent such notice shall state that such redemption is conditioned upon the receipt by the Trustee of moneys sufficient to pay the Redemption Price in the Currency in which the Bonds of such Series are payable, or upon the satisfaction of any other condition or the occurrence of any other event as shall be stated in such notice, the Corporation shall, prior to the redemption date, pay or cause to be paid to the Trustee an amount in cash and/or a principal amount of Investment Obligations maturing or redeemable at the option of the holder thereof not later than the date fixed for redemption which, in addition to other moneys, if any, available therefor held by the Trustee, will be sufficient to redeem on the redemption date at the Redemption Price thereof, plus interest accrued and unpaid to the redemption date, and in the Currency in which the Bonds of such Series are payable, all of the Bonds to be redeemed.

### **Redemption out of Sinking Fund Installments (Section 403)**

In addition to the redemption of Bonds pursuant to the Sections entitled “Privilege of Redemption and Redemption Price” and “Redemption at the Election of the Corporation” above, Term Bonds issued pursuant to the Resolution shall be subject to mandatory redemption by lot out of Sinking Fund Installments at a Redemption Price equal to the principal amount (or Compounded Amount, if applicable) thereof, in the Currency in which the Bonds of such Series are payable, on the dates and in the amounts set forth in the Supplemental Resolution pursuant to which such Bonds were issued.

In the case of any redemption of Bonds out of Sinking Fund Installments, the Corporation shall, in the case of each Sinking Fund Installment, give written notice to the Trustee of (i) the date of such Sinking Fund Installment, (ii) the unsatisfied balance of such Sinking Fund Installment (determined as provided in the Section entitled “Satisfaction of Sinking Fund Installments” and (iii) the particular Series and maturity of the Bonds to be redeemed from such Sinking Fund Installment. Such notice shall be given at least forty (40) days prior to the date of such Sinking Fund Installment, or such shorter period as shall be acceptable to the Trustee.

The Corporation shall, and covenants that it will, prior to the date of such Sinking Fund Installment, pay to the Trustee an amount in cash which, in addition to other moneys, if any, available therefor held by the Trustee, will be sufficient to redeem at the date of such Sinking Fund Installment, at

the Redemption Price thereof, plus interest accrued and unpaid to the date of the Sinking Fund Installment, in the Currency in which the Bonds of such Series are payable, all of the Bonds which are to be redeemed out of such Sinking Fund Installment.

#### **Selection of Bonds to be Redeemed in Partial Redemption (Section 404)**

In the event of redemption of less than all the Outstanding Bonds of a particular Series pursuant to the Section entitled “Privilege of Redemption and Redemption Price” and “Redemption at the Election of the Corporation,” the Corporation shall designate the maturities of the Bonds to be redeemed.

If less than all of the Outstanding Bonds of a particular Series and maturity are to be redeemed, except to the extent the related Series Resolution shall require that Bonds of such Series and maturity are to be redeemed on a pro rata basis, the Trustee shall assign to each such Outstanding Bond a distinctive number for each amount representing the lowest authorized denomination of the principal amount of such Bond and shall select by lot, using such method of lottery selection as it shall deem proper in its discretion, as many numbers as shall equal the principal amount (or Compounded Amount, if applicable) of such Bonds to be redeemed. For purposes of this Section, Bonds or portions thereof which have theretofore been selected by lot for redemption shall not be deemed to be Outstanding.

#### **The Pledge (Section 501)**

The Pledged Property, subject to the Section of the Resolution relating to compensating and indemnifying the Trustee, is pledged to the Trustee for the payment and as security for the payment of the Principal Installments and Redemption Price of and interest on the Bonds and payments due under Credit Facilities, and payments due under Liquidity Facilities and Qualified Hedges to the extent provided by a Supplemental Resolution, in each case in accordance with their terms and the provisions of the Resolution and subject to the provisions of the Resolution permitting the application of the Pledged Property for the purposes and on the terms and conditions set forth in the Resolution and in each case subject to the provisions regarding priority of payment as between Classes of Senior Bonds and Subordinate Bonds. Nothing contained in the Resolution shall prevent (i) a Credit Facility, Liquidity Facility, or Qualified Hedge from being provided with respect to any particular Bonds and not others, (ii) different reserves being provided pursuant to the Resolution with respect to Bonds than are provided for Parity Obligations or with respect to particular Bonds than are provided for other Bonds, or (iii) different reserves being provided with respect to particular Parity Obligations than are provided for other Parity Obligations.

To the fullest extent provided by the Act and other applicable law, the pledge provided by the preceding paragraph shall be valid and binding, and the Pledged Property shall immediately be subject to the lien of this pledge, without any physical delivery thereof or further act, and the lien of this pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Corporation, irrespective of whether such parties have notice thereof. Notwithstanding the foregoing, the Trustee and the Corporation shall execute the Security Agreement and the Corporation shall cause the proper filing of the Security Agreement in accordance with the Uniform Commercial Code as in effect in Puerto Rico.

#### **Establishment of Fund and Accounts (Section 502)**

Pursuant to the Resolution, the “Repayment Project Fund” is created and the following special Accounts and Subaccounts are created and established within the Repayment Project Fund, each of which shall have as a prefix “COFINA” and shall be held by the Trustee:

Upon written direction from the Corporation to establish such an account, a Costs of Issuance Account,

Capitalized Interest Account,

Bond Proceeds Account,

Revenue Account,

Debt Service Account, which shall contain therein a Principal Subaccount and an Interest Subaccount, and, if there shall be any Subordinate Bonds Outstanding, shall be established for each Class of Bonds,

Debt Service Reserve Account, and, if there shall be any Subordinate Bonds Outstanding, shall be established for each Class of Bonds,

Redemption Account, and

Rebate Account, which shall contain therein a Subaccount for each Series of Bonds or for more than one Series of Bonds that are treated as a single issue of bonds under the Code as specified in the applicable Tax Certificate.

The Corporation may establish and create such other Accounts in the Fund, or such other Subaccounts in any Account, as may be authorized pursuant to any Supplemental Resolution, including a Supplemental Resolution authorizing a Series of Bonds, and deposit therein such amounts as may from time to time be held for the credit of any Account or Subaccount.

Amounts held by the Corporation or by the Trustee at any time in the Fund or any Accounts and Subaccounts established pursuant to this Section, as the case may be, shall be held in trust in separate accounts and subaccounts of the Corporation and shall be applied only in accordance with the provisions of the Resolution and the Act.

### **Costs of Issuance Account and Capitalized Interest Account (Section 503)**

If the Corporation shall have determined, as evidenced by written direction to the Trustee, to establish a Costs of Issuance Account, there shall be deposited in the Costs of Issuance Account amounts, if any, determined to be deposited therein pursuant to a Supplemental Resolution containing the information required to be set forth by the Resolution. If the Corporation shall not have determined, as evidenced by written direction to the Trustee, to establish a Costs of Issuance Account, such amounts if any, determined to be disbursed for Costs of Issuance pursuant to a Supplemental Resolution containing the information required to be set forth in paragraph (xiv) of subsection 2 of Section 202 and authorizing the issuance of a Series of Bonds shall be disbursed upon issuance of a Series of Bonds to such Person as directed in writing to the Trustee by the Corporation.

There shall be deposited in the Capitalized Interest Account amounts, if any, determined to be deposited therein pursuant to the requirements of a Supplemental Resolution containing the information required to be set forth by the Resolution and authorizing the issuance of a Series of Bonds.

If amounts are on deposit in the Capitalized Interest Account or any Subaccount thereof, such amounts shall be transferred to the Interest Subaccount in the Debt Service Account on or prior to the Business Day preceding each Interest Payment Date in accordance with the requirements of the

Supplemental Resolution or Supplemental Resolutions authorizing such deposits to be made and providing for the application of such deposits.

Amounts on deposit in the Costs of Issuance Account or any Subaccount thereof, shall be applied to the payment of Costs of Issuance of Bonds, but only upon written certification by an Authorized Officer of the Corporation:

(i) setting forth the amount to be paid, the person or persons to whom such payment is to be made (which may be or include the Corporation) and, in reasonable detail, the purpose of such withdrawal; and

(ii) stating that the amount to be withdrawn from the Costs of Issuance Account or any Subaccount thereof is a proper charge thereon and that such charge has not been the basis of any previous withdrawal.

Any amounts on deposit (i) in the Costs of Issuance Account or any Subaccount thereof and not set aside by the Corporation, or set aside but determined by the Corporation to be no longer required, to pay Costs of Issuance of a Series of Bonds, and (ii) in the Capitalized Interest Account or any Subaccount thereof and not set aside by the Corporation, or set aside but determined by the Corporation to be no longer required, to pay interest on a Series of Bonds, shall be deposited as provided for in the immediately succeeding paragraph of this Section.

The Trustee shall deposit any funds described in the preceding paragraph in (i) the Bond Proceeds Account, (ii) the Revenue Account and/or (iii) the Redemption Account, in each case as shall be directed in writing by the Corporation; provided, however, in the case of proceeds of a Series of Tax Exempt Bonds, that prior to any deposit to the Revenue Account or the Redemption Account the Corporation and the Trustee shall have received an Opinion of Bond Counsel to the effect that such deposit is authorized or permitted to be made pursuant to the Resolution and that such deposit will not adversely affect the exclusion of interest on the Bonds from gross income for Federal income tax purposes.

In the event of the refunding of any Bonds, the Corporation may withdraw from the Capitalized Interest Account related to the Bonds to be refunded all or any portion of amounts accumulated therein with respect to the Bonds to be refunded and deposit such amounts as provided in such written direction specified in subsection 6 of this Section 503 of the Resolution; provided, however, that such withdrawal shall not be made unless immediately thereafter the Bonds being refunded shall be deemed to have been paid pursuant to the Section entitled "Defeasance" below.

#### **Bond Proceeds Account (Section 504)**

There shall be deposited in the Bond Proceeds Account any amounts which are required to be deposited therein pursuant to the Resolution, any Supplemental Resolution and any other amounts available therefor and determined by the Corporation to be deposited therein from time to time. Amounts in the Bond Proceeds Account shall be invested as directed in writing by the Corporation to the Trustee.

Except as otherwise provided in the applicable Supplemental Resolution, amounts deposited in the Bond Proceeds Account from the proceeds of sale of a Series of Bonds shall be applied (a) to pay, or reimburse the Commonwealth or any agency, instrumentality or public benefit corporation thereof, including the Corporation, for the prior payment by any such entity for, costs of the Repayment Project, and (b) for any Costs of Issuance of such Bonds the payment of which has not otherwise been provided for.

The Trustee shall apply amounts on deposit in the Bond Proceeds Account at any time for the purpose of making payments pursuant to this Section, but only upon certification by an Authorized Officer of the Corporation:

(i) setting forth the amount to be paid, the person or persons to whom such payment is to be made and, in reasonable detail, the purpose of such withdrawal; and

(ii) stating that the amount to be withdrawn from the Bond Proceeds Account is a proper charge thereon, and that such charge has not been the basis of any previous withdrawal.

Any amount remaining in the Bond Proceeds Account and not set aside by the Corporation for application in accordance with the applicable Supplemental Resolution shall be deposited in (i) the Revenue Account and/or (ii) the Redemption Account, in each case as may be directed by the Corporation; provided, however, in the case of proceeds of a Series of Tax Exempt Bonds, that the Corporation and the Trustee shall have received an Opinion of Bond Counsel to the effect that such deposit is authorized or permitted by the Resolution and will not adversely affect the exclusion of interest on the Bonds from gross income for Federal income tax purposes.

#### **Revenue Account (Section 505)**

All Revenues, upon receipt thereof, shall be deposited into the Revenue Account except as provided by Section 602.3; provided, however, that the proceeds of any draw on or payment under any Credit Facility which is intended for the payment of a Bond may be applied directly to such payment or deposited directly to the Debt Service Account for such purpose. In addition, there shall be deposited in the Revenue Account all other amounts required by the Resolution to be so deposited. Amounts on deposit from time to time in the Revenue Account shall be withdrawn and applied or transferred as of each Revenue Account Monthly Disbursement Date as follows and in the following order of priority:

FIRST: to the payment of (i) regularly scheduled fees of the Trustee and (ii) upon requisition in writing by the Corporation to the Trustee, Operating Expenses (but, with respect to clauses (i) and (ii), not to exceed the Operating Cap);

SECOND: to each Debt Service Account established for the Senior Bonds and Parity Obligations, allocated on a pro rata basis between the Principal Subaccount and the Interest Subaccount in each such Debt Service Account, all amounts until the amounts on deposit in all such Debt Service Accounts shall equal the Accrued Payment Obligation related to all Senior Bonds and Parity Obligations;

THIRD: to any Debt Service Reserve Account established for the Senior Bonds, the amount required to cause the amount on deposit therein to be at least equal to the Debt Service Reserve Requirement for the Senior Bonds;

FOURTH: to each Debt Service Account established for the Subordinate Bonds and Subordinate Obligations, in order of Class Priority, allocated on a pro rata basis between the Principal Subaccount and the Interest Subaccount in each such Debt Service Account, all amounts until the amounts on deposit in all such Debt Service Accounts shall equal the Accrued Payment Obligation related to all Subordinate Bonds and Subordinate Obligations;

FIFTH: to any Debt Service Reserve Accounts established for Subordinate Bonds, in order of Class Priority, the amount required to cause the amount on deposit therein to be at least equal to the Debt Service Reserve Requirements for such Subordinate Bonds;

SIXTH: the balance, if any, shall be applied upon written direction of the Corporation to the Trustee, provided that an amount at least equal to the Accrued Payment Obligation for all Senior Bonds, Subordinate Bonds, Parity Obligations and Subordinate Obligations for the ensuing twelve-month period (fifteen-month period for any Senior Bonds, Subordinate Bonds, Parity Obligations or Subordinate Obligations that have Principal Installments, interest or other scheduled principal or interest components due on a basis more frequently than semi-annually) shall be on deposit in the Debt Service Accounts pursuant to paragraph SECOND and FOURTH above, (x) to pay or provide for the payment of amounts payable under Credit Facilities, Liquidity Facilities and Qualified Hedges not otherwise required to be funded pursuant to paragraphs SECOND AND FOURTH above, until such amounts shall be fully paid or otherwise provided for from this or any other source, and then (y) for any of the purposes described in below, and then (z) for release to the Corporation, free and clear of the lien of the Resolution, to be applied for any lawful purpose of the Corporation.

Any moneys remaining in the Revenue Account at any time and not deposited, transferred or retained as set forth in subsection 1 above (i) may be retained in the Revenue Account, (ii) may be transferred to the Redemption Account, or (iii) may be used for (I) the payment or reimbursement of Financing Costs and for the payment of Operating Expenses in excess of the Operating Cap, and for the payment of Operating Expenses in excess of the Operating Cap, (II) the purchase of Bonds, (III) deposits to the Bond Proceeds Account pursuant to Section 504.1 of the Resolution or (IV) any combination of the foregoing, in each case as directed in writing by the Corporation to the Trustee.

Purchases of Bonds from amounts in the Revenue Account shall be made upon the written direction of an Authorized Officer of the Corporation, with or without advertisement and with or without notice to other Owners of Bonds. Such purchases shall be made at such price or prices as determined by such written instructions. If Sinking Fund Installments have been established for the maturities of Bonds purchased by the Corporation, then the Trustee, upon written instructions from an Authorized Officer of the Corporation, shall credit the principal amount purchased against future Sinking Fund Installments in direct chronological order, unless otherwise instructed in writing by an Authorized Officer of the Corporation at the time of such purchase.

#### **Debt Service Account (Section 506)**

There shall be transferred from the Revenue Account and deposited into the Interest Subaccount and the Principal Subaccount of each Debt Service Account, the amounts required to be so transferred pursuant to paragraphs SECOND and FOURTH under "Revenue Account" above.

There also shall be deposited into the Interest Subaccount of a Debt Service Account, if necessary, the following:

- (i) Such amount determined by the applicable Series Resolution representing accrued interest received upon the sale of a Series of Bonds.
- (ii) Amounts transferred from the Capitalized Interest Account for the payment of interest on the Bonds of such Series.



(iii) Amounts transferred from the Debt Service Reserve Account for the payment of interest on the Bonds and the interest component of Parity Obligations.

There also shall be deposited into the Principal Subaccount of a Debt Service Account, if necessary, the following:

(i) Amounts transferred from the Debt Service Reserve Account for the payment of Principal Installments of the Bonds and the principal component of Parity Obligations.

(ii) Amounts transferred from the Redemption Account for the payment of Principal Installments of any Bonds.

The Trustee shall pay out of the Interest Subaccount, to the Persons entitled thereto, (i) the interest on Bonds as and when due and payable, in the Currency in which the Bonds of such Series are payable, and (ii) the interest component of Parity Obligations at the times, in the manner and on the other terms and conditions as determined by the Corporation and set forth in written directions of an Authorized Officer of the Corporation delivered to the Trustee; provided, however, that amounts deposited to the Interest Account pursuant to clause (i) or (ii) of the second paragraph of this Section shall not be used to pay the interest component of Parity Obligations; and provided further, however, that if the amount available shall not be sufficient to pay in full all such interest due on the same date, then out of such available amount the Trustee shall make such payments under Bonds and Parity Obligations ratably, as determined by an Authorized Officer of the Corporation as evidenced in a written instrument delivered to the Trustee according to the amounts due on such date, without any discrimination or preference.

The Trustee shall pay out of the Principal Account, to the Persons entitled thereto, (i) each Principal Installment for the Bonds (including the Redemption Price payable upon mandatory redemption out of Sinking Fund Installments) as and when due and payable, in the Currency in which the Bonds of such Series are payable, and (ii) the principal component of Parity Obligations at the times, in the manner and on the other terms and conditions as determined by the Corporation and set forth in written directions of an Authorized Officer of the Corporation delivered to the Trustee; provided, however, that amounts deposited to the Principal Account pursuant to clause (ii) of the third paragraph of this Section shall not be used to pay the principal component of Parity Obligations; and provided further, however, that if the amount available shall not be sufficient to pay in full all such Principal Installments and principal due on the same date, then out of such available amount the Trustee shall make such payments under Bonds and Parity Obligations ratably, as determined by an Authorized Officer of the Corporation as evidenced in a written instrument delivered to the Trustee according to the amounts due on such date, without any discrimination or preference.

In the event of the refunding of any Bonds, the Trustee shall, upon the written direction of an Authorized Officer of the Corporation delivered to the Trustee, withdraw from the Debt Service Account all or any portion of amounts accumulated therein with respect to the Bonds to be refunded and deposit such amounts as provided in such written direction; provided, however, that such withdrawal shall not be made unless immediately thereafter the Bonds being refunded shall be deemed to have been paid pursuant to the Section entitled "Defeasance" below.

#### **Debt Service Reserve Account (Section 507)**

At the time any Series of Bonds is delivered pursuant to the Resolution, the Corporation shall pay into a Debt Service Reserve Account from the proceeds of such Bonds or other available funds, the amount, if any, necessary for the amount on deposit in such Debt Service Reserve Account to equal

the Debt Service Reserve Requirement applicable to Bonds of such Series and Class, after giving effect to any Reserve Account Cash Equivalent, calculated immediately after the delivery of such Series of Bonds.

Except as otherwise provided by Supplemental Resolutions, amounts on deposit in a Debt Service Reserve Account shall be applied, to the extent other funds are not available therefor pursuant to the Resolution and the applicable Supplemental Resolution, to pay when due the Principal Installments and Redemption Price of and the interest on the Outstanding Bonds of the related Class and the principal and interest components of Parity Obligations, by transfer to the Debt Service Account or the Redemption Account, as applicable.

Whenever the amount in a Debt Service Reserve Account exceeds the related Debt Service Reserve Requirement, after giving effect to any Reserve Account Cash Equivalent, the Trustee shall, if so directed in writing by an Authorized Officer of the Corporation, withdraw from such Debt Service Reserve Account the amount of any excess therein over the Debt Service Reserve Requirement as of the date of such withdrawal and deposit the moneys so withdrawn into the Revenue Account.

Moneys in a Debt Service Reserve Account may and, at the written direction of an Authorized Officer of the Corporation, shall be withdrawn from the Debt Service Reserve Account by the Trustee and deposited in the Redemption Account for the purchase or redemption of Bonds at any time, provided that subsequent to such purchase or redemption the amount in the Debt Service Reserve Account, after giving effect to any Reserve Account Cash Equivalent, will not be less than the related Debt Service Reserve Requirement. In the event of the refunding of any Bonds, the Trustee shall, upon the written direction of an Authorized Officer of the Corporation, withdraw from the related Debt Service Reserve Account all or any portion of amounts accumulated therein with respect to the Bonds being refunded and apply such amounts in accordance with such direction; provided, however, that such withdrawal shall not be made unless (i) immediately thereafter the Bonds being refunded shall be deemed to have been paid pursuant to the Section entitled "Defeasance" below and (ii) the amount remaining in the Debt Service Reserve Account, after giving effect to any Reserve Account Cash Equivalent, after such withdrawal shall not be less than the related Debt Service Reserve Requirement.

If a deficiency exists in a Debt Service Reserve Account, no later than the last Business Day of each calendar month the Trustee, upon written direction of an Authorized Officer of the Corporation, shall transfer from the Revenue Account, in accordance with the priorities set forth in of Section 505.1, and deposit in the Debt Service Reserve Account the amount, if any, required for the amount on deposit in the Debt Service Reserve Account to equal the related Debt Service Reserve Requirement as of the last day of such calendar month, after giving effect to any Reserve Account Cash Equivalent. Upon any withdrawal of amounts from the Debt Service Reserve Account, the Corporation shall provide written notice thereof to the Secretary of the Treasury and to the Director of the Office of Management and Budget. Pursuant to the authority of the Act, such notice to the Secretary of the Treasury shall include the instruction to provide funds for reimbursement of such withdrawal from the first Dedicated Sales Tax collected in the next ensuing Fiscal Year and, to the extent such amounts are insufficient to make a complete reimbursement thereof, from the first Dedicated Sales Taxes received in subsequent Fiscal Years after making the deposits required under Article 3(a) of the Act.

Whenever the amount in all Debt Service Reserve Accounts, without giving effect to any Reserve Account Cash Equivalent, together with the amount in all Debt Service Accounts, is sufficient to pay in full all Outstanding Bonds in accordance with their terms (including the maximum amount of Principal Installments and interest which could become payable thereon) and all amounts due and owing to Credit Facility Providers, the funds on deposit in the Debt Service Reserve Accounts shall be transferred to the Debt Service Account established for the same Class, and thereupon no further deposits shall be required to be made into the Debt Service Reserve Accounts. Prior to said transfer, all

investments held in the Debt Service Reserve Accounts shall be liquidated to the extent necessary in order to provide for the timely payment of the Principal Installments of and interest on Bonds.

Reserve Account Cash Equivalents may be deposited in the Debt Service Reserve Account as provided in this paragraph. In lieu of any required transfers of moneys to the Debt Service Reserve Account, the Corporation may cause to be deposited into the Debt Service Reserve Account a Reserve Account Cash Equivalent in an aggregate amount equal to the difference between the Debt Service Reserve Requirement and the sums of moneys or value of Investment Securities then on deposit in the Debt Service Reserve Account, if any. In lieu of retaining all or any portion of the moneys theretofore on deposit in the Debt Service Reserve Account, the Corporation may cause to be deposited into the Debt Service Reserve Account a Reserve Account Cash Equivalent in an aggregate amount equal to such moneys, subject to the third paragraph of this Section. Each Reserve Account Cash Equivalent shall be payable (upon the giving of notice as required thereunder) on any date on which moneys may be required to be withdrawn from the Debt Service Reserve Account. If a disbursement is made pursuant to a Reserve Account Cash Equivalent, the Corporation shall either (i) reinstate the maximum limits of such Reserve Account Cash Equivalent or (ii) deposit into the Debt Service Reserve Account funds in the amount of the disbursement made under such Reserve Account Cash Equivalent, or a combination of such alternatives, at the times and in the amounts required by the fifth paragraph of this Section. In the event that the rating attributable to any provider of any Reserve Account Cash Equivalent shall fall below that required in the definition thereof, such Reserve Account Cash Equivalent shall no longer be deemed to be a Reserve Account Cash Equivalent and the Corporation shall either (i) replace such Reserve Account Cash Equivalent with a Reserve Account Cash Equivalent which shall meet the requirements therefor or (ii) deposit into the Debt Service Reserve Account sufficient funds, or a combination of such alternatives, at the times and in the amounts required by the fifth paragraph of this Section.

Notwithstanding anything to the contrary contained in this Section, if amounts obtained under a Credit Facility or Reserve Account Cash Equivalent are to be used to pay the Principal Installments and Redemption Price of and interest on Bonds, then amounts in the Debt Service Reserve Account which would otherwise have been used for such purposes may be applied to reimburse the Credit Facility Provider for the amounts so obtained.

#### **Satisfaction of Sinking Fund Installments (Section 508)**

Any amount accumulated in the Debt Service Account up to the unsatisfied balance of each Sinking Fund Installment for Bonds may and, if so directed in writing by an Authorized Officer of the Corporation, shall be applied (together with amounts accumulated in the Debt Service Account with respect to interest on the Bonds for which such Sinking Fund Installment was established) by the Trustee prior to the forty-fifth day preceding the due date of such Sinking Fund Installment as follows: (i) to the purchase of Bonds of the maturity and interest rate for which such Sinking Fund Installment was established, at prices (including any brokerage and other charges) not exceeding the principal amount (or Compounded Amount, if applicable) of such Bonds plus unpaid interest accrued to the date of purchase, such purchases to be made in such manner as the Trustee shall determine; or (ii) to the redemption of such Bonds if then redeemable by their terms at the price equal to the principal amount (or Compounded Amount, if applicable) of such Bonds plus unpaid interest accrued to the date of redemption.

Upon the purchase or redemption of any Bond pursuant to the preceding paragraph, an amount equal to the principal amount (or Compounded Amount, if applicable) of the Bonds so purchased or redeemed shall be credited toward the next Sinking Fund Installment thereafter to become due with respect to the Bonds of such maturity and interest rate and the amount of any excess of the amounts so credited over the amount of such Sinking Fund Installment shall be credited against future Sinking Fund Installments in direct chronological order, unless otherwise instructed in writing by an Authorized Officer

of the Corporation at the time of such purchase or redemption. Concurrently with the delivery of such Bonds, the Corporation shall deliver to the Trustee a certificate of an Authorized Officer of the Corporation specifying (i) the principal amount (or Compounded Amount, if applicable), Series, maturity, interest rate and numbers of the Bonds so delivered, (ii) the date of the Sinking Fund Installment in satisfaction of which such Bonds are so delivered, (iii) the aggregate principal amount (or Compounded Amount, if applicable) of the Bonds so delivered, and (iv) the unsatisfied balance of such Sinking Fund Installment after giving effect to the delivery of such Bonds.

In satisfaction, in whole or in part, of any Sinking Fund Installment, the Corporation may deliver to the Trustee at least forty-five (45) days prior to the date of such Sinking Fund Installment, for cancellation, Bonds acquired by purchase of the Series and maturity and interest rate entitled to such Sinking Fund Installment. All Bonds so delivered to the Trustee in satisfaction of a Sinking Fund Installment shall reduce the amount of such Sinking Fund Installment by the aggregate principal amount (or Compounded Amount, if applicable) of such Bonds. Concurrently with such delivery of such Bonds the Corporation shall deliver to the Trustee a certificate of an Authorized Officer of the Corporation specifying (i) the principal amount (or Compounded Amount, if applicable), Series, maturity, interest rate and numbers of the Bonds so delivered, (ii) the date of the Sinking Fund Installment in satisfaction of which such Bonds are so delivered, (iii) the aggregate principal amount (or Compounded Amount, if applicable) of the Bonds so delivered, and (iv) the unsatisfied balance of each such Sinking Fund Installment after giving effect to the delivery of such Bonds.

In the event that Bonds are redeemed prior to maturity pursuant to any Section hereof other than Section 403, there shall be credited the principal amount (or Compounded Amount, if applicable) of the Bonds so redeemed against Sinking Fund Installments due hereunder; provided, however, that the Corporation shall have delivered to the Trustee, at least forty-five (45) days prior to the date of such Sinking Fund Installment, a certificate of an Authorized Officer of the Corporation specifying (i) the principal amount, Series, maturity, interest rate and number of each Bond so redeemed, (ii) the date of each Sinking Fund Installment in satisfaction of which such redeemed Bonds are credited, (iii) the aggregate principal amount (or Compounded Amount, if applicable) of the Bonds so redeemed, and (iv) the unsatisfied balance of each such Sinking Fund Installment after giving effect to the redemption of such Bonds.

The Trustee shall, upon receipt of the notice specified by the Section entitled "Redemption out of Sinking Fund Installments" above and in the manner provided in the Resolution, call for redemption on the date of each Sinking Fund Installment falling due prior to maturity such principal amount (or Compounded Amount, if applicable) of Bonds of the Series and maturity entitled to such Sinking Fund Installment as is required to exhaust the unsatisfied balance of such Sinking Fund Installment. The Trustee shall redeem such Bonds with moneys as set forth in the Section entitled "Redemption out of Sinking Fund Installments" above.

#### **Redemption Account; Amounts to be Deposited Therein (Section 509)**

The following, upon receipt thereof, shall be deposited into the Redemption Account:

- (i) amounts determined pursuant to the sixth paragraph of the Section entitled "Costs of Issuance Account and Capitalized Interest Account" above;
- (ii) amounts determined pursuant to the fourth paragraph of the Section entitled "Bond Proceeds Account" above;

(iii) amounts determined pursuant to the second paragraph of the Section entitled “Revenue Account” above; and

(iv) amounts transferred from the Debt Service Reserve Account for the payment of the Redemption Price of Bonds.

Subject to the limitations contained in the final paragraph of this Section, if, on the last Business Day preceding any interest payment date for Bonds, Principal Installment due date for Bonds, or due date of interest or principal components of Parity Obligations, the amount on deposit in the Debt Service Account shall be less than the interest on Bonds due on such interest payment date, the Principal Installment for Bonds due on such Principal Installment due date, or the interest or principal components of Parity Obligations due on the due date thereof, and after giving effect to any amounts available therefor in the Debt Service Reserve Account, then the Trustee, upon written direction of an Authorized Officer of the Corporation, shall transfer from the Redemption Account to the Debt Service Account an amount (or all of the moneys in the Redemption Account if less than the amount required) which will be sufficient to make up such deficiency in the Debt Service Account.

To the extent not required to make up a deficiency as required in the second paragraph of this Section, amounts in the Redemption Account shall be applied by the Trustee, as promptly as practicable after delivery to it of written instructions from an Authorized Officer of the Corporation, to the purchase or redemption (including the payment of redemption premium, if any) of Bonds. Interest on Bonds so purchased or redeemed shall be paid from the Debt Service Account and all expenses in connection with such purchase or redemption shall be paid by the Corporation from moneys held in the Revenue Account pursuant to the second paragraph of the Section entitled “Revenue Account” above.

The transfers required by the second paragraph of this Section shall be made from amounts in the Redemption Account only to the extent that such amounts are not then required to be applied to the redemption of Bonds for which notice of redemption shall have been given pursuant to the Resolution, unless such notice is conditioned upon the availability of moneys on deposit in the Redemption Account.

### **Rebate Account (Section 510)**

The Rebate Account and the amounts deposited therein shall not be subject to a security interest, pledge, assignment, lien or charge in favor of the Trustee, any Owner of any Bond, any other Beneficiary or any other Person.

The Trustee shall deposit in the Rebate Account such amounts and at such times as shall be specified in written instructions from an Authorized Officer of the Corporation delivered to the Trustee.

The Trustee shall withdraw from the Rebate Account such amounts and at such times, and deposit such amounts in the Revenue Account, as shall be specified in written instructions from an Authorized Officer of the Corporation delivered to the Trustee.

The Trustee shall have no responsibility or liability for the calculation of amounts required to be deposited in the Rebate Account under federal tax law.

## **Investment of Funds, Accounts and Subaccounts Held by the Trustee (Section 602)**

Moneys in any Fund, Account or Subaccount held by the Trustee shall be continuously invested and reinvested or deposited and redeposited by the Trustee upon the written direction of an Authorized Officer of the Corporation. The Corporation shall direct the Trustee to invest and reinvest the moneys in any Fund, Account or Subaccount held by the Trustee in Investment Obligations so that the maturity date or date of redemption at the option of the holders shall coincide as nearly as practicable with the times at which moneys are anticipated to be needed to be expended. The Investment Obligations purchased by the Trustee shall be held by it, or for its account as Trustee. The Trustee, at the written direction of the Corporation as to specific investments, shall sell, or present for redemption, any Investment Obligations purchased by it as an investment whenever it shall be necessary in order to provide moneys to meet any payment from such Fund, Account or Subaccount. The Trustee shall have no obligation to invest, reinvest, deposit, redeposit or sell investments contemplated by the Resolution except upon the written direction of an Authorized Officer of the Corporation as to specific investments. The Trustee shall have no liability for interest on any money received by it hereunder (except as otherwise agreed in writing with the Corporation and except that the Trustee shall invest such money as required pursuant to written direction of an Authorized Officer of the Corporation) and no responsibility for any loss (after giving effect to any interest or other income thereon except to the extent theretofore paid to the Corporation) incurred on the sale of such investments. The Trustee shall advise the Corporation in writing on or before the 20<sup>th</sup> day of each calendar month of all investments held for the credit of each Fund, Account or Subaccount in its custody under the provisions of the Resolution as of the end of the preceding month.

Moneys in any Fund, Account or Subaccount held by the Corporation shall be invested in Investment Obligations as determined by the Corporation.

Investment Obligations purchased under the provisions of the Resolution as an investment of moneys in any Fund, Account or Subaccount, whether held by the Trustee or the Corporation, shall be deemed at all times to be a part of such Fund, Account or Subaccount but, unless otherwise expressly provided in the Resolution or any Supplemental Resolution, (i) the income or interest earned and gains realized in excess of losses suffered by any Fund, Account (other than the Rebate Account) or Subaccount (other than any Subaccount in the Rebate Account) due to the investment thereof shall be deposited, upon written direction from an Authorized Officer of the Corporation to the Trustee, in the Rebate Account and if not required to be so deposited in the Rebate Account, because no such written direction was received, shall be deposited in the Bond Proceeds Account so long as there are moneys on deposit in the Capitalized Interest Account and, at any time that there are no moneys on deposit in the Capitalized Interest Account, shall be transferred for deposit in the Revenue Account, and (ii) all such income and interest received from any Investment Obligation on deposit in the Rebate Account shall remain in such Account. The Trustee shall keep a record of all such amounts deposited in the Revenue Account to indicate the source of the income or earnings.

The Trustee shall sell, or present for redemption or exchange, any Investment Obligation purchased by it pursuant to the Resolution or any Supplemental Resolution whenever it shall be requested in writing by an Authorized Officer of the Corporation to do so or whenever it shall be necessary in order to provide moneys to meet any payment or transfer from the Fund, Account or Subaccount for which such investment was made, except that any Investment Obligation may be credited to more than one Fund, Account or Subaccount based upon the portions thereof purchased by or allocable to each such Fund, Account or Subaccount and need not be sold in order to provide for the transfer of amounts from one Fund, Account or Subaccount to another. The Trustee shall advise the Corporation in writing, on or before the twentieth day of each calendar month, of all investments held for the credit of each Fund,

Account or Subaccount in its custody under the provisions of the Resolution as of the end of the preceding month.

Nothing in the Resolution shall prevent any Investment Obligations acquired as investments of or security for Funds, Accounts or Subaccounts held under the Resolution from being issued or held in book-entry form on the books of the Corporation of the Treasury of the United States or any national securities depository.

In the event that the Trustee has not, prior to 11:00 a.m. on any Business Day, received investment instructions as provided herein as to any investment proceeds received hereunder, the Trustee shall invest the same in Investment Obligations having the shortest available maturity, in accordance with standing instructions received from an Authorized Officer of the Corporation.

### **Particular Covenants of the Corporation**

#### *Payment of Obligations (Section 701)*

The Corporation shall duly and punctually pay or cause to be paid the principal and premium, if any, on every Bond and the interest thereon, and all Parity Obligations and Subordinate Obligations, at the date(s) and place(s) and in the manner mentioned in the Resolution, the applicable Supplemental Resolution, the Bonds, and applicable Credit Facilities, Liquidity Facilities, and Qualified Hedges according to the true intent and meaning thereof, and shall duly and punctually satisfy all Sinking Fund Installments which may be established for any Series, subject to the provisions of Section 201. If, at the end of any Fiscal Year, the amount of Pledged Sales Tax received by the Trustee during such Fiscal Year shall be less than the Article 5(e) Amount applicable to such Fiscal Year, the Corporation shall take such actions as necessary to invoke the provisions of Section 5(e) of the Act to increase the amount of Pledged Sales Tax to cover such insufficiency in the next ensuing Fiscal Year. In addition, if the amount of Pledged Sales Tax applicable to a Fiscal Year shall be less than the Pledged Sales Tax Base Amount for such Fiscal Year, the Corporation shall provide written notice thereof to the Secretary of the Treasury and to the Director of the Office of Management and Budget. Such notice shall include the instruction to the Secretary of the Treasury to provide available funds to make up the shortfall, and to the Director of the Office of Management and Budget to include in the recommended budget for the current Fiscal Year or the next Fiscal Year the appropriations necessary to cover such shortfall, in each case as provided in paragraph (a) of Article 45 of the Act and the second sentence of paragraph (e) of Article 5 of the Act.

#### *Further Assurance (Section 704)*

At any and all times the Corporation shall, so far as it may be authorized by law, pass, make, do, execute, acknowledge and deliver, all and every such further resolutions, acts, deeds, conveyances, assignments, transfers and assurances and record the same in any office or register as may be necessary or desirable for the better assuring, conveying, granting, assigning and confirming all and singular the rights and other moneys, securities and funds pledged or assigned by the Resolution, or intended so to be, or which the Corporation may become bound to pledge or assign and, if required by law, to perfect the security interest created thereby.

#### *Agreement of the Commonwealth (Section 706)*

Pursuant to the Act, the Corporation includes in the Resolution, for the benefit of the Bondowners and the Beneficiaries, the pledge of the Commonwealth that it will not limit or restrain the rights or powers conferred by the Act or the right of the Corporation to meet its agreements with Bondowners, until the Bonds, irrespective of their maturity, together with the interest on the same, are

completely paid and redeemed and that no amendment to the Act shall undermine any obligation or commitment of the Corporation.

*Creation of Liens (Section 707)*

Until the pledge created by Resolution shall be discharged and satisfied as provided in the Section entitled “Defeasance” below, the Corporation shall not (i) issue any bonds or other evidences of indebtedness secured by a pledge of the Pledged Property held or set aside by the Corporation or by the Trustee under the Resolution, nor create or cause to be created any lien or charge on the Pledged Property, other than as permitted by the Resolution, (ii) at any time when the Corporation is in default in making any payment required to be made under the Resolution or maintaining the balance in any Fund, Account or Subaccount required to be maintained in the amount required therefor by the Resolution, set apart or appropriate and pay any amount in any Fund, Account or Subaccount except as required by the Resolution, nor (iii) issue any bonds or other evidences of indebtedness, other than the Bonds, secured by a pledge of any revenues, rates, fees, charges, rentals or other earned income or receipts, as derived in cash by or for the account of the Corporation, pledged under the Resolution. The Corporation may not issue Bonds with a payment priority or claim against the Pledged Property that is senior to that of the Senior Bonds. The Corporation, in its discretion, may determine to execute and deliver Subordinate Bonds and incur Subordinate Obligations of one or more Classes and payment priorities which are subordinate to the payment priorities accorded to the Senior Bonds under the Resolution.

*Accounts and Reports (Section 708)*

The Corporation shall keep proper books of record and account (separate from all other records and accounts) in which complete and correct entries shall be made of its transactions relating to the Pledged Property and each Fund, Account and Subaccount established under the Resolution, and which, together with all books and papers of the Corporation relating to the Repayment Project, shall at all reasonable times during normal business hours be subject to the inspection of the Trustee and the Owners of an aggregate of not less than 25% in principal amount of the Bonds then Outstanding or their representatives duly authorized in writing (it being understood that the Trustee shall have to duty to inspect).

The Corporation shall file with the Trustee and each Credit Facility Provider, Liquidity Facility Provider and Qualified Hedge Provider forthwith upon becoming aware of any Event of Default, or the occurrence of any event which with notice or lapse of time or both would be an Event of Default, a certificate signed by an Authorized Officer of the Corporation specifying any Event of Default or other event as described in this paragraph, and specifying the nature and status of such Event of Default or other such event.

*Tax Matters (Section 709)*

The covenants of this Section are made solely for the benefit of the Owners of, and shall be applicable solely to, all Bonds except Bonds to which the Corporation determines in a Supplemental Resolution that this Section shall not apply.

The Corporation will not make, or give its consent to the Trustee or any other Person to make, any use of the proceeds of the Bonds or of any moneys which may be deemed to be the proceeds of the Bonds pursuant to Section 148 of the Code which, if reasonably expected to have been so used on the date of issuance of the Bonds would have caused any of the Bonds to have been “arbitrage bonds” within the meaning of said Section 148 and the regulations in effect thereunder at the time of such use and applicable to obligations issued on the date of issuance of the Bonds.



The Corporation shall at all times do and perform all acts and things necessary or desirable and within its power in order to assure that interest paid on the Bonds shall be excluded from gross income for Federal income tax purposes.

Notwithstanding any other provision of the Resolution, including in particular the Section entitled "Defeasance" below, the obligation to comply with the requirements of this Section shall survive the defeasance or payment in full of the Bonds.

*Issuance of Additional Bonds; Incurrence of Additional Parity Obligations and Subordinate Obligations; Payment of Obligations (Section 710)*

No Series of Bonds in addition to the Series 2008A Bonds may be issued without compliance with Section 202 and no Series of Senior Bonds may be issued in addition to the Series 2008A Bonds, and no Parity Obligations in addition to Parity Obligations incurred on the date of issuance of the Series 2008A Bonds may be incurred, unless the Corporation shall have filed with the Trustee a certificate of an Authorized Officer of the Corporation reflecting:

A. (i) the Pledged Sales Tax Base Amount applicable to the Fiscal Year in which such additional Senior Bonds are to be issued or Parity Obligations are to be incurred, (ii) the Accrued Payment Obligation due on the Senior Bonds, including such additional Senior Bonds, the amount of such Parity Obligations due, and the Operating Cap applicable, in such Fiscal Year, (iii) the Pledged Sales Tax Base Amount for each subsequent Fiscal Year taking into account the four percent (4%) minimum adjustment thereto provided in the Act and applicable to each Fiscal Year beginning July 1, 2008, and (iv) the Accrued Payment Obligation that will be due on the Senior Bonds, including such additional Senior Bonds, the amount of such Parity Obligations due, and the Operating Cap applicable, in each subsequent Fiscal Year, and showing that the amount in clause (i) at least equals the amount in clause (ii) and the amount for each subsequent Fiscal Year in clause (iii) at least equals the amount for such Fiscal Year in clause (iv).

B. (i) the total amount of Commonwealth Sales Tax assumed to be received in each Fiscal Year during which Senior Bonds and Parity Obligations, including such additional Senior Bonds or additional Parity Obligations, are to be outstanding under the Resolution, based on the assumption that the Commonwealth Sales Tax actually received in the Fiscal Year immediately preceding the date of issuance of such additional Senior Bonds or incurrence of such additional Parity Obligations is to be increased for each subsequent Fiscal Year by 4%, and (ii) the total Accrued Payment Obligation scheduled for all Outstanding Senior Bonds and amounts due on all Parity Obligations, including such additional Senior Bonds and additional Parity Obligations, in each such Fiscal Year, and showing, for each such Fiscal Year, that the related amount shown in (B)(i) is at least 3 times the related amount shown in (B)(ii).

In the event that amounts are paid to providers of Qualified Hedges, Credit Facilities or Liquidity Facilities pursuant to the transfers of funds required by the Resolution which do not represent scheduled payments or reimbursements in accordance with the terms of the related contracts, but represent costs, indemnities, termination payments or similar non-recurring amounts, or in the event such unscheduled amounts are due to such providers and there are insufficient funds held hereunder and available for the payment thereof, the Corporation shall provide written notice thereof to the Secretary of the Treasury and to the Director of the Office of Management and Budget. Pursuant to the authority of the Act, such notice to the Secretary of the Treasury shall include the instruction to provide funds to the Trustee for the payment or reimbursement of such payments, from the first Dedicated Sales Tax collected in the next ensuing Fiscal Year after making the deposits required by Article 3(a) of the Act and, to the extent such amounts are insufficient to make a complete reimbursement thereof, from the first Dedicated

Sales Taxes received in subsequent Fiscal Years after making the deposits required by Article 3(a) of the Act. Any such amounts paid by the Secretary of the Treasury shall be deposited in the Revenue Account.

The Corporation may issue Subordinate Bonds or incur Subordinate Obligations at any time subject to the requirements of the related Series Resolution and without compliance with the requirements of the Resolution.

#### *General (Section 711)*

The Corporation shall do and perform or cause to be done and performed all acts and things required to be done or performed by or on behalf of the Corporation under the provisions of the Act and the Resolution.

Upon the date of authentication and delivery of any of the Bonds, all conditions, acts and things required by law and the Resolution to exist, to have happened and to have been performed precedent to and in the issuance of such Bonds shall exist, shall have happened and shall have been performed and the issue of such Bonds, together with all other indebtedness of the Corporation, shall be within every debt and other limit prescribed by the laws of the Commonwealth.

#### **Responsibilities of Trustee (Section 802)**

The Trustee undertakes to perform such duties and only such duties as are specifically set forth in the Resolution, and no implied covenants or obligations shall be read into the Resolution against the Trustee. The recitals of fact in the Resolution and in the Bonds contained shall be taken as the statements of the Corporation and the Trustee assumes no responsibility for the correctness of the same. The Trustee makes no representations as to the validity or sufficiency of the Resolution or any Supplemental Resolution or of any Bonds issued thereunder or as to the security afforded by the Resolution or any Supplemental Resolution, and the Trustee shall incur no liability in respect thereof. The Trustee makes no representations as to the value, condition or sufficiency of any assets pledged or assigned as security for the Bonds, the right, title or interest of the Corporation therein, the security provided thereby or by the Resolution, the feasibility of the Repayment Project, the compliance by the Repayment Project with the Act, or the tax-exempt status of Bonds. The Trustee shall, however, be responsible for its representation contained in its certificate of authentication on the Bonds. The Trustee shall be under no responsibility or duty with respect to the authentication and delivery of the Bonds for value or the application of the proceeds thereof or the application of any moneys paid to the Corporation. The Trustee shall not be responsible for the validity, perfection, priority or enforceability of the pledge and security interest in the Pledged Property created or intended to be created by the Resolution, whether or not impaired by operation of law. No provision of the Resolution shall be deemed to impose any duty or obligation on the Trustee to perform any act or acts, receive or obtain any interest in property or exercise any interest in property, or exercise any right, power, duty or obligation conferred or imposed on it in any jurisdiction in which it shall be illegal, or in which the Trustee shall be unqualified or incompetent in accordance with applicable law, to perform any such act or acts, to receive or obtain any such interest in property or to exercise any such right, power, duty or obligation. The Trustee shall be under no obligation or duty to perform any act which would involve it in expense or liability or to institute or defend any suit in respect hereof, or to advance any of its own moneys, unless provided with security and indemnity satisfactory to it. The Trustee shall be under no obligation to exercise any of the rights or powers vested in it by the Resolution at the request or direction of any of the Owners pursuant to the Resolution, unless such Owners shall have offered to the Trustee security or indemnity satisfactory to the Trustee against the costs, expenses and liabilities which might be incurred by it in compliance with such request or direction. The permissive right of the Trustee to take actions enumerated in the Resolution shall not be construed as a duty. The Trustee shall not be liable in connection with the performance of its

duties under the Resolution except for its own gross negligence or willful misconduct. The Trustee shall not be liable for any error of judgment made in good faith by an Authorized Officer of the Trustee, unless it shall be proved that the Trustee was grossly negligent in ascertaining the pertinent facts. The Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Owners of a majority in principal amount of the Outstanding Bonds relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred upon the Trustee under the Resolution. The Trustee shall not be liable for any action taken, suffered, or omitted to be taken by it in good faith and believed by it to be authorized or within the discretion or rights or powers conferred upon it by the Resolution. Anything in the Resolution notwithstanding, in no event shall the Trustee be liable for special, indirect, punitive or consequential loss or damage of any kind whatsoever (including but not limited to loss of profit), even if the Trustee has been advised as to the likelihood of such loss or damage and regardless of the form of action. Whether or not therein expressly so provided, every provision of the Resolution relating to the conduct or affecting the liability of or affording protection to the Trustee shall be subject to the provisions of the Resolution.

#### **Evidence on Which Trustee May Act (Section 803)**

The Trustee may conclusively rely and shall be fully protected in acting or refraining from acting upon any notice, resolution, request, consent, order, direction, certificate, report, opinion, bond, or other paper or document believed by it to be genuine, and to have been signed or presented by the proper party or parties. The Trustee may consult with counsel, who may or may not be of counsel to the Corporation, and the advice of such counsel or any Opinion of Counsel shall be full and complete authorization and protection in respect of any action taken or omitted to be taken or suffered by it under the Resolution in the absence of bad faith and in reliance thereon; provided, however, that such opinion of counsel shall not relieve the Trustee from obtaining an Opinion of Bond Counsel when and if required under the Resolution.

Whenever the Trustee shall deem it necessary or desirable that a matter be proved or established prior to taking or omitting to take or suffering any action under the Resolution, such matter (unless other evidence in respect thereof be therein specifically prescribed) may be deemed to be conclusively proved and established by a certificate of an Authorized Officer of the Corporation, and such certificate shall be full warrant and protection for any action taken or omitted to be taken or suffered, in the absence of bad faith, under the provisions of the Resolution in reliance thereon.

Except as otherwise expressly provided in the Resolution, any request, order, notice or other direction required or permitted to be furnished pursuant to any provision thereof by the Corporation to the Trustee shall be sufficiently evidenced if executed in the name of the Corporation by an Authorized Officer of the Corporation.

#### **Compensation and Indemnification (Section 804)**

The Corporation shall pay to the Trustee from time to time reasonable compensation for all services rendered under the Resolution (which compensation shall not be limited by any provision of law in regard to the compensation of a trustee of an express trust), and also all reasonable expenses, charges, counsel fees and other disbursements, including those of its attorneys, agents, and employees, incurred in and about the performance of their powers and duties under the Resolution and the Trustee shall have a lien prior to that of the Bondowners and other Beneficiaries therefor on any and all funds at any time held by it under the Resolution. The Corporation further agrees to indemnify and save the Trustee harmless against any loss, liability or expenses including taxes (other than taxes based upon, measured by or determined by the income of the Trustee), arising out of or in connection with the

acceptance or administration of the trust or trusts hereunder, including the costs and expenses of defending itself against any claim (whether asserted by the Corporation or any Bondowner or any other Person) or liability in connection with the exercise or performance of any of its powers or duties hereunder, or in connection with enforcing the provisions of this Section, except to the extent that such loss, damage, claim, liability or expense is due to its own gross negligence or willful misconduct. In addition to, but without prejudice to its other rights under the Resolution, when the Trustee incurs expenses or renders services in connection with an a bankruptcy or similar event, the expenses (including the reasonable charges and expenses of its counsel) and the compensation for the services are intended to constitute expenses of administration under any applicable federal or state bankruptcy, insolvency or other similar law. "Trustee" for purposes of Section 804 of the Resolution shall include any predecessor Trustee; provided, however, that the negligence, willful misconduct or bad faith of any Trustee hereunder shall not affect the rights of any other Trustee hereunder. The obligations of the Corporation and the lien provided for under the Resolution shall survive the satisfaction and discharge of the Bonds, the termination for any reason of the Resolution or the earlier resignation or removal of the Trustee. The Trustee shall not be required to expend any of its own funds in the execution of its duties pursuant to the provisions of the Resolution.

#### **Certain Permitted Acts (Section 805)**

The Trustee may become the owner of any Bonds, with the same rights it would have if it were not the Trustee. To the extent permitted by law, the Trustee may act as depositary for, and permit any of its officers or directors to act as a member of, or in any other capacity with respect to, any committee formed to protect the rights of Bondowners or to effect or aid in any reorganization growing out of the enforcement of the Bonds or the Resolution, whether or not any such committee shall represent the Owners of a majority in principal amount of the Bonds then Outstanding.

#### **Resignation of Trustee (Section 806)**

The Trustee may at any time resign and be discharged of the duties and obligations created by the Resolution by giving not less than 30 days' written notice to the Corporation (which shall give prompt written notice to each Beneficiary) and to the Bondowners (mailed, postage prepaid), specifying the date when such resignation shall take effect, and such resignation shall take effect upon the day specified in such notice unless (i) no successor shall have been appointed by such date in which case such resignation shall become effective upon the appointment of a successor, or (ii) previously a successor shall have been appointed by the Corporation or the Bondowners as provided in the Section entitled "Appointment of Successor Trustee" below, in which event such resignation shall take effect immediately on the appointment of such successor.

#### **Removal of Trustee (Section 807)**

The Trustee may be removed at any time, with or without cause, by an instrument or concurrent instruments in writing, delivered to the Trustee, and signed by the Owners of a majority in principal amount of the Bonds then Outstanding or their attorneys-in-fact duly authorized, excluding any Bonds held by or for the account of the Corporation, or, so long as no Event of Default or event which with the giving of notice or the passage of time would constitute an Event of Default has occurred and is continuing, by an instrument in writing delivered to the Trustee and signed by an Authorized Officer of the Corporation; provided, however, that in each case that a successor Trustee shall be simultaneously appointed with the filing of such instrument.

### **Appointment of Successor Trustee (Section 808)**

In case at any time the Trustee shall resign or shall be removed or shall become incapable of acting, or shall be adjudged bankrupt or insolvent, or if a receiver, liquidator or conservator of the Trustee, or of its property, shall be appointed, or if any public officer shall take charge or control of the Trustee, or of its property or affairs, a successor may be appointed by the Owners of a majority in principal amount of the Bonds then Outstanding, excluding any Bonds held by or for the account of the Corporation, by an instrument or concurrent instruments in writing signed and acknowledged by such Bondowners or by their attorneys-in-fact duly authorized and delivered to such successor Trustee, notification thereof being given to the Corporation and the predecessor Trustee; provided, nevertheless, that unless a successor Trustee shall have been appointed by the Bondowners as aforesaid, the Corporation by a duly executed written instrument signed by an Authorized Officer of the Corporation shall forthwith appoint a Trustee to fill such vacancy until a successor Trustee shall be appointed by the Bondowners as authorized in this Section. The Trustee shall mail a copy of the notice of any such appointment, postage prepaid, to the Owners of any Bonds, at their last addresses appearing on the registry books. Any successor Trustee appointed by the Corporation shall, immediately and without further act, be superseded by a Trustee appointed by the Bondowners.

If in a proper case no appointment of a successor Trustee shall be made pursuant to the foregoing provisions of this Section within 30 days after the Trustee shall have given to the Corporation written notice as provided in the Section entitled "Removal of Trustee" above or after a vacancy in the office of the Trustee shall have occurred by reason of its inability to act or its removal under this Section, the Trustee or the Owner of any Bond may apply to any court of competent jurisdiction to appoint a successor Trustee. Said court may thereupon, after such notice, if any, as such court may deem proper, appoint a successor Trustee.

Any Trustee appointed under the provisions of this Section in succession to the Trustee shall be a bank or trust company organized under the laws of a state of the United States of America or of the Commonwealth, or a national banking association, and having a capital and surplus aggregating at least \$50,000,000, if there be such a bank or trust company or national banking association willing and able to accept the office on reasonable and customary terms and authorized by law to perform all the duties imposed upon it by the Resolution.

### **Supplemental Resolutions (Article IX)**

#### *Supplemental Resolutions Effective upon Filing with the Trustee (Section 901)*

For any one or more of the following purposes and at any time or from time to time, the Corporation may adopt a Supplemental Resolution which, upon the filing with the Trustee of a copy thereof certified by an Authorized Officer of the Corporation, shall be fully effective in accordance with its terms:

- (i) to close the Resolution against, or provide limitations and restrictions in addition to the limitations and restrictions contained in the Resolution on, the authentication and delivery of the Bonds or the issuance of other evidences of indebtedness;
- (ii) to add to the covenants and agreements of the Corporation in the Resolution, other covenants and agreements to be observed by the Corporation which are not contrary to or inconsistent with the Resolution as theretofore in effect;

(iii) to add to the limitations and restrictions in the Resolution, other limitations and restrictions to be observed by the Corporation which are not contrary to or inconsistent with the Resolution as theretofore in effect;

(iv) to surrender any right, power or privilege reserved to or conferred upon the Corporation by the Resolution to the extent such surrender is for the benefit of the Owners of the Bonds;

(v) to authorize Bonds of a Series and, in connection therewith, specify and determine the matters and things referred to in the Section of the Resolution relating to the general provisions for the issuance of Bonds, and also any other matters and things relative to such Bonds which are not contrary to or inconsistent with the Resolution as theretofore in effect, or to amend, modify or rescind any such authorization, specification or determination at any time prior to the first authentication and delivery of such Bonds;

(vi) to confirm, as further assurance, any pledge under, and the subjection to any lien or pledge created or to be created by, the Resolution, of the Pledged Property or of any other moneys, securities, funds or accounts;

(vii) to modify any of the provisions of the Resolution as may be necessary or desirable to provide for the issuance of Bonds in book entry form pursuant to the Resolution;

(viii) to cure any ambiguity, defect or inconsistent provision in the Resolution;

(ix) to provide such provisions with respect to Subordinate Bonds as are necessary and desirable, provided, that no such provisions shall adversely affect the payment priorities under the Resolution of any Bonds then Outstanding;

(x) to provide for a pledge of Pledged Property for the payment and as security for Liquidity Facilities and Qualified Hedges as permitted by the Section entitled "Pledge" above.

(xi) as permitted by the Resolution prior to the issuance and delivery of the first series of Bonds under the Resolution; and

(xii) to insert such provisions clarifying matters or questions arising under the Resolution as are necessary or desirable and are not contrary to or inconsistent with the Resolution as theretofore in effect; or

(xiii) to modify any of the provisions of the Resolution or any previously adopted Supplemental Resolution in any respect whatsoever, provided that (i) such modification shall be, and be expressed to be, effective only after all Bonds of any Series Outstanding at the date of the adoption of such Supplemental Resolution shall cease to be Outstanding and (ii) such Supplemental Resolution shall be specifically referred to in the text of all Bonds of any Series authenticated and delivered after the date of the adoption of such Supplemental Resolution and of Bonds issued in exchange therefor or in place thereof.

*Supplemental Resolutions Effective with Consent of Bondowners (Section 903)*

At any time or from time to time, the Corporation may adopt a Supplemental Resolution subject to consent by Bondowners in accordance with and subject to the provisions of Resolution relating to the amendment of the Resolution, which Supplemental Resolution, upon the delivery to the Trustee of a copy thereof certified by an Authorized Officer of the Corporation, and upon compliance with the provisions of the Section of the Resolution relating to amendment of the Resolution, shall become fully effective in accordance with its terms as provided in said Section.

*General Provisions (Section 904)*

The Resolution shall not be modified or amended in any respect except as provided in and in accordance with and subject to the provisions of Resolution relating to Supplemental Resolutions and to amendment of the Resolution. Nothing in the Resolution relating to Supplemental Resolutions and to amendment of the Resolution shall affect or limit the right or obligation of the Corporation to adopt, make, execute, acknowledge or deliver any resolution, act or other instrument pursuant to the provisions of the Section entitled "Further Assurances" above or the right or obligation of the Corporation to execute and deliver to the Trustee any instrument which elsewhere in the Resolution it is provided shall be delivered to the Trustee.

Any Supplemental Resolution referred to and permitted or authorized by the Sections entitled "Supplemental Resolutions Effective Upon Filing with the Trustee" or "Supplemental Resolutions Effective Upon Consent of the Trustee" may be adopted by the Corporation without the consent of any of the Bondowners, but shall become effective only on the conditions, to the extent and at the time provided in said Sections, respectively. The copy of every Supplemental Resolution when delivered to the Trustee shall be accompanied by an Opinion of Bond Counsel stating that such Supplemental Resolution has been duly and lawfully adopted in accordance with the provisions of the Resolution, is authorized or permitted by the Resolution, and is valid and binding upon the Corporation and enforceable in accordance with its terms.

The Trustee is authorized to accept the delivery of a certified copy of any Supplemental Resolution referred to and permitted or authorized by the Resolution and to make all further agreements and stipulations which may be therein contained, and the Trustee, in taking such action in good faith, shall be fully protected in relying on an Opinion of Bond Counsel that such Supplemental Resolution is authorized or permitted by the provisions of the Resolution.

No Supplemental Resolution shall change or modify any of the rights or obligations of the Trustee without its written assent thereto.

**Powers of Amendment (Section 1002)**

Any modification or amendment of the Resolution and of the rights and obligations of the Corporation and of the Owners of the Bonds may be made by a Supplemental Resolution, with the written consent given as provided in the Resolution, (i) of the Owners of at least a majority in principal amount of the Bonds Outstanding at the time such consent is given, and (ii) in case less than all of the several Series of Bonds then Outstanding are affected by the modification or amendment, of the Owners of at least a majority in principal amount of the Bonds of each Series so affected and Outstanding at the time such consent is given; provided, however, that if such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified like Series and maturity remain Outstanding, the consent of the Owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under this Section. No such modification or

amendment shall permit a change in the terms of redemption or maturity of the principal (or Compounded Amount, if applicable) of any Outstanding Bond or of any installment of interest thereon or a reduction in the principal amount (or Compounded Amount, if applicable) or the Redemption Price thereof or in the rate of interest thereon without the consent of each Bondowner affected thereby, or shall reduce the percentage of the aggregate principal amount (or Compounded Amount, if applicable) of Bonds or otherwise affect classes of Bonds the consent of the Owners of which is required to effect any such modification or amendment without the consent of all Bondowners, or shall change or modify any of the rights or obligations of the Trustee without its written assent thereto, or shall change or modify any of the rights of the providers of Qualified Hedges, Credit Facilities or Liquidity Facilities regarding source of and security for payments due to such Persons. For the purposes of this Section, a Series shall be deemed to be affected by a modification or amendment of the Resolution if the same adversely affects or diminishes the rights of the Owners of Bonds of such Series. The Trustee may in its discretion determine whether or not in accordance with the foregoing powers of amendment, Bonds of any particular Series or maturity would be affected by any modification or amendment of the Resolution and any such determination if reasonable and in good faith shall be binding and conclusive on the corporation and all Owners of Bonds.

## **Events of Default and Remedies (Article XI)**

### *Events of Default (Section 1101)*

Each of the following events shall constitute an Event of Default under the Resolution:

(i) There shall occur a default in the payment of principal or Redemption Price of or interest on any Bond or payments due to any Parity Obligation or any Subordinate Obligation related thereto after the same shall have become due, whether at maturity or upon call for redemption or otherwise.

(ii) There shall occur a failure to observe, or a refusal to comply with, the terms of the Resolution or the Bonds, other than a failure or refusal constituting an event specified in paragraph (i) of this subsection; provided, however, that with respect to any failure to observe or refusal to comply with the covenants and agreements set forth in the Resolution, such failure or refusal shall have continued for a period of thirty (30) days after written notice, specifying such failure and requesting that it be remedied, is given to the Corporation by the Trustee or any Beneficiary; and provided further, however, that if the failure stated in the notice cannot be remedied within the thirty-day period, corrective action has been instituted by the Corporation within such thirty-day period and is being diligently pursued;

*provided*, that Owners of Subordinate Bonds or obligees under Subordinate Obligations may not declare an Event of Default, or cause the Trustee to take any remedial actions hereunder in the event such Subordinate Bonds or Subordinate Obligations are not timely paid amounts due thereunder, until such time that Senior Bonds and all Parity Obligations are fully retired or are defeased in accordance with the provisions of the Resolution, and all references in Article XI of the Resolution to the Owners of Bonds exercising or directing the exercise of default remedies shall refer solely to those Bonds as to which an Event of Default has been declared hereunder.

The exercise by the Commonwealth of its right to amend, modify, repeal or otherwise alter statutes imposing or relating to the Commonwealth Sales Tax, as described in the Resolution, shall not constitute a default or Event of Default under the Resolution.



In the event that the Corporation shall issue one or more Classes of Subordinate Bonds, or execute Subordinate Obligations, the related Series Resolution shall provide for the determination of Events of Default, and the imposition of remedies contained elsewhere in this Article XI, in accordance with the Class Priority set forth in such Series Resolution, which Class Priority shall in all cases provide that all Senior Bonds and all Parity Obligations related thereto shall be accorded senior status such that no Event of Default may be declared for default related to such Subordinate Bonds or Subordinate Obligations, and no remedy may be invoked under this Article XI for any such default on Subordinate Bonds or Subordinate Obligations, until the Senior and all Parity Obligations related thereto are fully retired or are defeased in accordance with the provisions of the Resolution.

*Remedies (Section 1102)*

Upon the happening and continuance of any Event of Default, then and in each such case the Trustee may proceed, and, upon the written request of the Owners of not less than twenty-five per centum (25%) in principal amount of the Outstanding Bonds shall, shall, declare the principal of and accrued interest on the Bonds to be immediately due and payable (Capital Appreciation Bonds at their Compounded Amount on the date of acceleration). Upon any such declaration, the principal of (Compounded Amount for Capital Appreciation Bonds) and accrued interest on the accelerated Bonds shall become due and payable immediately, and the Trustee shall make demand for payment upon the Corporation in an amount sufficient to pay principal of (Compounded Amount for Capital Appreciation Bonds) and interest accrued on the accelerated Bonds to the date established for payment thereof. In any such event, any Credit Facility Provider may elect to pay an amount equal to the accelerated principal (Compounded Amount) of and interest accrued on the Bonds covered by its Credit Facility to the date of acceleration and the Trustee shall accept such payment. In addition, the Trustee may, and upon the written request of the Owners of not less than twenty-five per centum (25%) in principal amount of the Outstanding Bonds, shall, proceed to protect and enforce its rights and the rights of the Bondowners by such of the following remedies, as the Trustee, being advised by counsel shall deem most effectual to protect and enforce such rights subject to the provisions of Sections 201, 803 and 1206:

- (i) by suit, action or proceeding to enforce all rights of the Bondowners, including the right to collect or require the Corporation to collect Revenues adequate to carry out the covenants, agreements and pledges with respect thereto contained in the Resolution and to require the Corporation to carry out any other covenant or agreement with Bondowners and to perform its duties under the Act;
- (ii) by suit upon the Bonds limited, upon recovery thereunder, to the Pledged Property pledged under the Resolution;
- (iii) by action or suit in equity, to require the Corporation to account as if it were the trustee of an express trust for the Bondowners, for the Pledged Property and assets pledged under the Resolution as shall be within its control; and
- (iv) by action or suit in equity, to enjoin any acts or things which may be unlawful or in violation of the rights of the Bondowners or the Beneficiaries.

In the enforcement of any remedy under the Resolution, but subject to the Sections entitled "Authorization of Bonds," "The Pledge" and "No Personal Liability," the Trustee shall be entitled to sue for, enforce payment on and receive any and all amounts then or during any default becoming, and at any time remaining, due from the Corporation for principal, Redemption Price, interest or otherwise for Bonds under any provision of the Resolution or any Supplemental Resolution or of the Bonds, and unpaid, with interest on overdue payments at the rate or rates of interest specified in such

Bonds, together with any and all costs and expenses of collection and of all proceedings under the Resolution and under such Bonds, without prejudice to any other right or remedy of the Trustee or of the Bondowners, and to recover and enforce judgment or decree against the Corporation for any portion of such amounts remaining unpaid, with interest, costs and expenses, in any manner provided by law, the moneys adjudged or decreed to be payable.

*Priority of Payments After Event of Default (Section 1103)*

Subject to Section 804 and after making provision for the payment of any reasonable expenses of the Trustee and its agents and attorneys necessary in the opinion of the Trustee to protect the interests of the Owners of the Bonds and the other Beneficiaries, and for the payment of the reasonable charges and expenses and liabilities incurred and advances made by the Trustee and its agents and attorneys in the performance of their duties under the Resolution, in the event that the funds held by the Trustee shall be insufficient for the payment of interest and principal or Compounded Amount or Redemption Price then due on the Bonds and other amounts payable as described in clauses FIRST through FIFTH below, such funds (excluding funds held for the payment or redemption of particular Bonds which have theretofore become due at maturity or by call for redemption) and any other moneys received or collected by the Trustee and any moneys or other property distributable in respect of the Corporation's obligations under the Resolution after the occurrence of an Event of Default, shall be applied as follows:

Unless the principal (or Compounded Amount, if applicable) of all of the Bonds shall have become due and payable,

FIRST: to the payment to the Persons entitled thereto of regularly scheduled fees payable under each Credit Facility and Liquidity Facility;

SECOND: to the payment to the Persons entitled thereto of all installments of interest on the Bonds and the interest component of Parity Obligations then due in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installment due on the same date, then to the payment thereof ratably, according to the amounts due on such date, without any discrimination or preference;

THIRD: to the payment to the Persons entitled thereto of the unpaid principal or Redemption Price of the Bonds and the unpaid principal component of Parity Obligations which shall have become due, whether at maturity or by call for redemption, in the order of their due dates and, if the amount available shall not be sufficient to pay in full all the Bonds and the principal component of Parity Obligations due on the same date, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, without any discrimination or preference;

FOURTH: to the payment to the Persons entitled thereto of amounts reimbursable or payable by the Corporation under each Credit Facility for draws or payments thereunder to pay principal of or interest on Bonds, whether such reimbursements or payments are made to the Credit Facility Provider as a Bondowner, as a subrogee or otherwise; and

FIFTH: to the payment to the Persons entitled thereto of amounts payable by the Corporation under each Credit Facility, Liquidity Facility and Qualified Hedge not constituting Parity Obligations or payable pursuant to clause FIRST OR FOURTH above;

provided, that if the principal of all the Bonds shall have become or shall have been declared due and payable, all such moneys shall be applied in accordance with the provisions of

SECOND and THIRD above, ratably, without preference or priority of principal (Compounded Amount) over interest or of interest over principal (Compounded Amount) or of any installment of interest over any other installment of interest, and, provided further, in the event of an insufficiency of funds to make all payments required under any of clauses FIRST through FIFTH above, funds shall be applied to the payments required under the relevant clause, without preference or priority, ratably according to the amounts due.

The provisions of this Section are in all respects subject to the provisions of the Resolution relating to extending the payment of Bonds.

Whenever moneys are to be applied by the Trustee pursuant to this Section, such moneys shall be applied by the Trustee at such times, and from time to time, as provided above. The deposit of such moneys with the Trustee, or otherwise setting aside such moneys in trust for the proper purpose, shall constitute proper application by the Trustee and the Trustee shall incur no liability whatsoever to the Corporation, to any Bondowner to any Beneficiary or to any other Person for any delay in applying any such moneys, so long as the Trustee acts without gross negligence or willful misconduct. Whenever the Trustee shall exercise such discretion in applying such moneys, it shall fix the date (which shall be an interest payment date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee shall give such notice as it may deem appropriate for the fixing of any such date. The Trustee shall not be required to make payment to the Owner of any Bond unless such Bond shall be presented to the Trustee for appropriate endorsement or for cancellation if fully paid.

#### *Termination of Proceedings (Section 1104)*

In case any proceeding taken by the Trustee on account of any Event of Default has been discontinued or abandoned for any reason, then in every such case the Corporation, the Trustee, the Beneficiaries and the Bondowners shall be restored to their former positions and rights under the Resolution, respectively, and all rights, remedies, powers and duties of the Trustee shall continue as though no other such proceeding had been taken.

#### *Borrowers' Direction of Proceedings (Section 1105)*

Anything in the Resolution to the contrary notwithstanding, the Owners of a majority in principal amount of the Bonds then Outstanding shall have the right, by an instrument or concurrent instruments in writing executed and delivered to the Trustee, to direct the method of conducting all remedial proceedings to be taken by the Trustee hereunder, provided that such direction shall not be otherwise than in accordance with law or the provisions of the Resolution, including Section 804 hereof, and that the Trustee shall have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Bondowners not parties to such direction or would involve the Trustee in personal liability.

#### *Limitation on Rights of Bondowners (Section 1106)*

No Owner of any Bond shall have any right to institute any suit, action, mandamus or other proceeding in equity or at law under the Resolution, or for the protection or enforcement of any right under the Resolution unless such Owner shall have given to the Trustee written notice of the Event of Default or breach of duty on account of which such suit, action or proceeding is to be taken, and unless the Owners of not less than 25% in principal amount of the Bonds then Outstanding shall have made written request of the Trustee after the right to exercise such powers or right of action, as the case may be, shall have occurred, and shall have afforded the Trustee a reasonable opportunity either to proceed to

exercise the powers granted in the Resolution or granted under the law or to institute such action, suit or proceeding in its name and unless, also, there shall have been offered to the Trustee reasonable security and indemnity against the costs, expenses (including legal fees and expenses) and liabilities to be incurred therein or thereby, and the Trustee shall have refused or neglected to comply with such request within a reasonable time; and such notification, request and offer of indemnity are declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the powers under the Resolution or for any other remedy provided under the Resolution or by law. It is understood and intended that no one or more Owners of the Bonds or other Beneficiary secured by the Resolution shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Resolution, or to enforce any right under the Resolution or under law with respect to the Bonds, or the Resolution, except in the manner provided in the Resolution, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner provided in the Resolution and for the benefit of all Owners of the Outstanding Bonds. Nothing contained in the Resolution relating to defaults and remedies shall affect or impair the right of any Bondowner to enforce the payment of the principal of and interest on such Owner's Bonds or the obligation of the Corporation to pay the principal of (or Compounded Amount, if any) and interest on each Bond issued under the Resolution to the Owner thereof at the time and place in said Bond expressed.

Anything to the contrary in this Section notwithstanding, or any other provision of the Resolution, each Owner of any Bond by such Owner's acceptance thereof, shall be deemed to have agreed that any court in its discretion may require, in any suit for the enforcement of any right or remedy under the Resolution, or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the reasonable costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable pre-trial, trial and appellate attorneys' fees, against any party litigant in any such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant; but the provisions of this paragraph shall not apply to any suit instituted by the Trustee, to any suit instituted by any Bondowner or group of Bondowners holding at least 25% in principal amount of the Bonds Outstanding, or to any suit instituted by any Bondowner for the enforcement of the payment of any Bond on or after the respective due date thereof expressed in such Bond.

*Remedies Not Exclusive (Section 1108)*

No remedy conferred upon or reserved to the Trustee or to the Owners of the Bonds is intended to be exclusive of any other remedy and each and every such remedy shall be cumulative and shall be in addition to any other remedy given under the Resolution or now or hereafter existing at law or in equity or by statute.

*No Waiver of Default (Section 1109)*

No delay or omission of the Trustee or of any Owner of the Bonds to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or an acquiescence therein and every power and remedy given by the Resolution to the Trustee and the owners of the Bonds or such Beneficiaries, respectively, may be exercised from time to time and as often as may be deemed expedient.

*Notice of Event of Default (Section 1110)*

The Trustee shall give to the Bondowners and the Beneficiaries notice of each Event of Default hereunder known to the Trustee within ninety days after actual knowledge by an Authorized Officer of the Trustee of the occurrence thereof, unless such Event of Default shall have been remedied or

cured before the giving of such notice. However, except in the case of default in the payment of the principal (or Compounded Amount, if any) or Redemption Price, if any, of or interest on any of the Bonds, the Trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee, or a trust committee of directors or responsible officers of the Trustee in good faith determines that the withholding of such notice is in the interest of the Bondowners and other Beneficiaries. Each such notice of Event of Default shall be given by the Trustee by mailing written notice thereof: (i) to all Owners of Bonds, as the names and addresses of such Owners appear upon the books for registration and transfer of Bonds as kept by the Trustee, and (ii) to each of the Rating Agencies.

*Defeasance (Section 1201)*

Bonds which are denominated and payable only in Dollars may be defeased pursuant to the provisions of Section 1201 of the Resolution. Bonds denominated in a Foreign Currency or Currencies may be defeased pursuant to the provisions contained herein, as affected by the provisions of the related Series Resolution. The Corporation shall pay and indemnify the Trustee against any tax, fee or other charge imposed on or assessed against the Defeasance Securities deposited pursuant as described herein or the principal and interest received in respect thereof other than any such tax, fee or other charge which by law is for the account of the Bondowners.

If the Corporation shall pay or cause to be paid, or there shall otherwise be paid, to the Owners of all Bonds then Outstanding, the principal and interest and Redemption Price, if any, to become due thereon, at the times and in the manner stipulated therein and in the Resolution, then, at the option of the Corporation, expressed in an instrument in writing signed by an Authorized Officer of the Corporation and delivered to the Trustee, the covenants, agreements and other obligations of the Corporation to the Bondowners shall be discharged and satisfied. In such event, and provided that all amounts owing to the Trustee and all Beneficiaries shall have been fully paid, the Trustee shall, upon the request of the Corporation, execute and deliver to the Corporation such instruments as may be desirable to evidence such discharge and satisfaction and the Trustee shall pay over or deliver to the Corporation all money, securities and funds held by them pursuant to the Resolution which are not required for the payment or redemption of Bonds not theretofore surrendered for such payment or redemption.

Bonds or any portion thereof for the payment or redemption of which moneys shall have been set aside and shall be held in trust by the Trustee (through deposit by the Corporation of funds for such payment or redemption or otherwise) at the maturity or redemption date thereof shall be deemed to have been paid within the meaning and with the effect expressed herein. Any Outstanding Bonds of any Series or any maturity within a Series or portion thereof shall prior to the maturity or redemption date thereof be deemed to have been paid within the meaning and with the effect expressed herein if (a) in case any of said Bonds are to be redeemed on any date prior to their maturity, the Corporation shall have given to the Trustee irrevocable instructions to give, as provided in Article IV of the Resolution, notice of redemption on said date of such Bonds, (b) there shall have been deposited with the Trustee either moneys in an amount which shall be sufficient, or Defeasance Securities the principal of and interest on which when due and without reinvestment, except as provided below, will provide moneys which, together with the moneys, if any deposited with the Trustee at the same time, shall be sufficient to pay when due the principal or Redemption Price, if applicable, and interest due and to become due on said Bonds on and prior to the redemption date or maturity date thereof, as the case may be, and (c) in the event said Bonds (or portions thereof) are not by their terms subject to redemption or maturity within the next succeeding 60 days, the Corporation shall have given the Trustee irrevocable instructions to mail, not less than seven (7) days after receipt of such instructions, a notice to the Owners of the Bonds (or portion thereof) which are to be deemed to have been paid hereunder that the deposit required by (b) above has been made with the Trustee and that said Bonds or portion thereof are deemed to have been paid in

accordance herein and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal or Redemption Price, if applicable, on said Bonds or portion thereof, including the interest accrued thereon. Such notice shall be mailed, postage prepaid, to the Owners of said Bonds or portion thereof at their last mailing address, if any, appearing on the registry books, but such mailing shall not be a condition precedent to the deemed payment of such Bonds and failure so to mail, or failure by any Owner to receive, any such notice shall not affect the validity of the defeasance of such Bonds as herein provided for.

Neither Defeasance Securities nor moneys deposited with the Trustee as established herein, nor principal or interest payments on any such Defeasance Securities, shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal or Redemption Price, if applicable, and interest on said Bonds; provided that any cash received from such principal or interest payments on such Defeasance Securities deposited with the Trustee, if not then needed for such purpose, shall, to the extent practicable, be reinvested by the Trustee at the written direction of the Corporation in Defeasance Securities maturing at the time or times and in amounts sufficient to pay when due the principal or Redemption Price, if applicable, and interest to become due on said Bonds on and prior to such redemption date or maturity date thereof, as the case may be. Any income or interest earned by, or increment to, the investment of any such moneys so deposited, in excess of the amounts required hereinabove to pay the principal of, Redemption Price, if applicable, and interest on such Bonds, as realized, shall be deposited by the Trustee in the Revenue Account. To the extent required by the provider of a Credit Facility, the Bonds which are the subject of the enhancement of such Credit Facility shall not be deemed paid hereunder unless there shall have been delivered to the Trustee and the provider of such Credit Facility (a) a verification report of a firm of independent accountants verifying the sufficiency of the escrow created hereunder to timely make full payment of principal or Redemption Price, if applicable, and interest on such Bonds to the dates scheduled for such payment, and (b) an opinion of Bond Counsel to the effect that, based upon the assumptions stated in such opinion, such Bonds are deemed defeased under the provisions of the Resolution.

For purposes of determining whether Adjustable Rate Bonds shall be deemed to have been paid prior to the maturity or redemption date thereof, as the case may be, by the deposit of moneys, or Investment Securities and moneys, if any, in accordance with the second sentence of subsection 3 of Section 1201 of the Resolution, the interest to come due on such Adjustable Rate Bonds on or prior to the maturity date or redemption date thereof, as the case may be, shall be calculated at the Contractual Maximum Interest Rate permitted by the terms thereof; provided, however, that if on any date, as a result of such Adjustable Rate Bonds having borne interest at less than such Contractual Maximum Interest Rate for any period, the total amount of moneys and Investment Securities on deposit with the Trustee for the payment of interest on such Adjustable Rate Bonds is in excess of the total amount which would have been required to be deposited with the Trustee on such date in respect of such Adjustable Rate Bonds in order to satisfy the second sentence of subsection 2 of Section 1201 of the Resolution, the Trustee shall, if requested by the Corporation, pay the amount of such excess to the Corporation free and clear of any trust, pledge, lien, encumbrance or security interest created hereby.

Option Bonds shall be deemed to have been paid in accordance with the second sentence of subsection 23 of Section 1201 of the Resolution only if, in addition to satisfying the requirements of clauses (a) and (c) of such sentence, there shall have been deposited with the Trustee moneys in an amount which shall be sufficient to pay when due the maximum amount of principal of and premium, if any, and interest on such Bonds which could become payable to the Owners of such Bonds upon the exercise of any options provided to the Owners of such Bonds; provided, however, that if, at the time a deposit is made with the Trustee pursuant to subsection 23 of Section 1201 of the Resolution, the options originally exercisable by the Owner of an Option Bond are no longer exercisable, such Bond shall not be considered an Option Bond for purposes established herein. If any portion of the moneys deposited with

the Trustee for the payment of the principal and premium, if any, and interest on Option Bonds is not required for such purpose, the Trustee shall, if requested by the Corporation in writing, pay the amount of such excess to the Corporation free and clear of any trust, pledge, lien, encumbrance or security interest created hereby.

Anything in the Resolution to the contrary notwithstanding, but subject to any applicable law to the contrary, any moneys held by the Trustee in trust for the payment of the principal of or premium, if any, or interest on any of the Bonds which remain unclaimed for two (2) years after the date when such principal, premium, if any, or interest, as the case may be, has become due and payable, either at their stated maturity dates or by call for earlier redemption or otherwise, if such moneys were held by the Trustee at such date, or for two (2) years after the date of deposit of such moneys if deposited with the Trustee after the said date when such principal, premium, if any, or interest, as the case may be, became due and payable, shall, at the written request of the Corporation, be repaid by the Trustee to the Corporation, as its absolute property and free from trust, and the Trustee shall thereupon be released and discharged with respect thereto and the Bondowners shall look only to the Corporation for the payment of such principal, premium, if any, or interest, as the case may be; provided, however, that before being required to make any such payment to the Corporation, the Trustee shall, at the expense of the Corporation, cause to be published once in a newspaper or financial journal, customarily published at least once a day for at least five (5) days (other than legal holidays) in each calendar week, printed in the English language and of general circulation in the Borough of Manhattan, City and State of New York, a notice that said moneys remain unclaimed and that, after a date named in said notice, which date shall be not less than thirty (30) days after the date of the publication of such notice, the balance of such moneys then unclaimed will be returned to the Corporation.

#### **Moneys Held for Particular Bonds (Section 1203)**

The amounts held by the Trustee for the payment of the interest, principal or Redemption Price due on any date with respect to particular Bonds shall, on and after such date and pending such payment, be set aside on its books and held in trust by it for the Owners of such Bonds.

#### **Preservation and Inspection of Documents (Section 1204)**

All documents received by the Trustee under the provisions of the Resolution shall be retained in its possession and shall be subject at all reasonable times to the inspection of the Corporation, and any Bondowner or other Beneficiary and their agents and their representatives any of whom may make copies thereof.

#### **No Personal Liability (Section 1206)**

Neither the members of the Corporation nor any other Person executing the Bonds shall be subject to any personal liability or accountability by reason of the issuance or execution and delivery thereof.

#### **Governing Law (Section 1211)**

The Resolution shall be governed by, and construed and enforced in accordance with, the laws of the Commonwealth; provided, however, that the formalities leading to the creation of the trusts contain in the Resolution shall be governed by the laws of the State of New York and, provided further, to the maximum extent permitted by applicable law, the rights, duties, privileges and immunities of the Trustee, any Paying Agent and Bond Registrar, shall be governed by the law of the jurisdiction in which its Corporate Trust Office is located.

**PROPOSED FORM OF APPROVING OPINION OF  
BOND COUNSEL TO THE CORPORATION**

June 26, 2008

Puerto Rico Sales Tax Financing Corporation  
Roberto Sánchez Vilella Government Center  
De Diego Avenue, Stop 22  
San Juan, Puerto Rico 00940

**Re:     \$737,046,992.35  
          Puerto Rico Sales Tax Financing Corporation  
          Series 2008A Bonds**

Ladies and Gentlemen:

We have examined the Constitution and the laws of the Commonwealth of Puerto Rico (the “Commonwealth”), including Act No. 91 of the Legislature of Puerto Rico, approved May 13, 2006, as amended and supplemented (the “Act”), creating the Puerto Rico Sales Tax Financing Corporation (the “Corporation”) as an independent governmental instrumentality of the Commonwealth.

We have also examined a certified copy of a resolution adopted by the Board of Directors of the Corporation on July 13, 2007 (the “General Resolution”) and a Fourth Supplemental resolution adopted by the Board of Directors on June 25, 2008 (together with the General Resolution, the “Resolution”), and other proofs submitted relative to the Corporation’s \$737,046,992.35 Sales Tax Revenue Bonds, Series 2008A (the “Bonds”).

The Bonds are issuable as fully registered Bonds, without coupons, in denominations of \$5,000 (maturity amount) each or integral multiples thereof.

The Bonds are issued under and pursuant to the Resolution for the purpose of providing funds for the payment or retirement of certain “extraconstitutional” debt as authorized under the Act.

The Bonds are limited obligations of the Corporation payable solely from and secured by a pledge and assignment of undisbursed Bond proceeds, certain funds held under the Resolution, together with income earned thereon, the Pledged Sales Tax receipts and other Revenues (as defined in the Resolution) derived therefrom (collectively referred to herein as the “Pledged Property”) pledged therefor under the General Resolution.

The Bonds bear interest and are subject to redemption prior to maturity as set forth in the Resolution.

The principal of the Bonds is payable at the principal corporate trust office of the Trustee in New York, New York. The interest on the Bonds is payable by check mailed to the registered owner at the



address appearing on the registration books of the Corporation on the relevant record date or, in certain circumstances set forth in the Resolution, by wire transfer to a designated account.

From such examination, and having regard to legal questions we deem relevant, we are of the opinion that:

(1) The Act is valid in all respects material to this opinion, and the Corporation is a duly constituted public corporation and governmental instrumentality of the Commonwealth.

(2) The Resolution has been duly adopted by, and is legal, valid and binding upon, the Corporation, enforceable in accordance with its terms.

(3) The Bonds have been duly authorized by the Corporation and constitute legal, valid and binding limited obligations of the Corporation payable solely from, and secured by a valid and binding pledge of, the Pledged Property, subject only to the provisions of the Resolution permitting use of such Pledged Property and its application for the purposes and on the terms and conditions provided in the Resolution.

(4) The Bonds do not constitute a debt, obligation or pledge of the full faith, credit or taxing power of the Commonwealth or any of its municipalities or political subdivisions or instrumentalities (other than the Corporation), and neither the Commonwealth nor any of its municipalities or political subdivisions or instrumentalities (other than the Corporation), shall be liable for the payment thereof.

(5) Under the provisions of the Acts of Congress now in force and under existing statutes and court decisions, (a) interest on the Bonds is included in gross income for Federal income tax purposes, except that no opinion is expressed with respect to certain Federal income tax matters covered by the opinion of Fiddler, Gonzalez & Rodriguez, P.S.C., Special Tax Counsel to the Corporation, delivered to the Corporation on the date of delivery of the Bonds, and (b) the Bonds, and the interest thereon, are exempt from state, the Commonwealth of Puerto Rico and local taxation.

We express no opinion regarding any other Federal, Commonwealth or state tax consequences with respect to the Bonds. We are rendering our opinion under existing statutes and court decisions as of the issue date, and assume no obligation to update our opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. We express no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the inclusion of interest on the Bonds in gross income for Federal income tax purposes, or under state, Commonwealth or local tax law.

In rendering this opinion, we are advising you that the enforceability of the Bonds and the Bond Resolution may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

We have also examined an executed Bond and in our opinion the form of said Bond and its execution are regular and proper.

Very truly yours,

**PROPOSED FORM OF OPINION OF  
SPECIAL TAX COUNSEL**

June 26, 2008

PUERTO RICO SALES TAX FINANCING CORPORATION  
Roberto Sánchez Vilella Government Center  
De Diego Avenue, Stop 22  
San Juan, Puerto Rico 00940

**Re:     \$737,046,922.35**  
**Puerto Rico Sales Tax Financing Corporation**  
**Sales Tax Revenue Bonds, Series 2008A**

Gentlemen:

In connection with the issuance on the date hereof by the Puerto Rico Sales Tax Financing Corporation (the “Corporation”) of its Sales Tax Revenue Bonds, Series 2008A (collectively, the “Bonds”), you have requested our opinion with respect to the treatment for Puerto Rico tax purposes of the ownership and disposition of the Bonds.

We have examined Act No. 91 of the Legislature of Puerto Rico, approved May 13, 2006, as amended (the “Act”), creating the Corporation. The Corporation is a body corporate and politic constituting a public corporation and governmental instrumentality of Commonwealth of Puerto Rico (the “Commonwealth” or “Puerto Rico”) exercising public and essential governmental functions.

From such an examination, we are of the opinion that:

1. Interest on the Bonds is exempt from Puerto Rico income and withholdings taxes, including the alternative minimum tax imposed by Section 1017 of the Puerto Rico Internal Revenue Code of 1994, as amended (the “P.R. Code”);
2. The Bonds are exempt from property taxes imposed by the Municipal Property Tax Act of 1991, as amended, and interest thereon is exempt from the municipal license tax imposed by the Municipal License Tax Act of 1974, as amended;
3. The transfer of the Bonds by (i) gift will not be subject to gift tax under the P.R. Code in the case of donors who are residents of the Commonwealth at the time the gift is made and (ii) death will not be subject to estate tax under the P.R. Code in the case of a decedent who at the time of death was (x) a resident of Puerto Rico, and (y) a United States citizen who acquired such citizenship solely by reason of birth or residence in Puerto Rico;
4. Gain recognized from the sale or exchange of a Bond will be subject to income tax under the P.R. Code to taxpayers subject to Puerto Rico income tax on such gains, including individuals residing in Puerto Rico and corporations and partnerships organized under the laws of the Commonwealth;

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

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

In addition to the opinions above we would like to bring to your attention that: (a) the P.R. Code does not provide rules with respect to the treatment of the excess, if any, of the amount due at maturity of a Bond over its initial offering price (the “Accretion Amount”) and that under the current administrative practice followed by the Puerto Rico Department of the Treasury, the Accretion Amount is treated as interest; and (b) prospective owners of the Bonds, including but not limited to financial institutions, should be aware that ownership of the Bonds may result in having a portion of their interest and other expenses attributable to interest on the Bonds disallowed as deductions for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

7. Based on the provisions of the United States Internal Revenue of 1986, as amended (the “U.S. Code”), and the regulations thereunder, now in force:

(a) Interest on the Bonds received by, or “original issue discount” (within the meaning of the U.S. Code) accrued to, an individual who is a *bona fide* resident of Puerto Rico within the meaning of Section 937 of the U.S. Code during the entire taxable year in which such interest is received or “original issue discount” is accrued will constitute gross income from sources within Puerto Rico and, therefore, is excludable from gross income for purposes of the U.S. Code pursuant to section 933(1) thereof; and

(b) Interest received or accrued, or “original issue discount”, on the Bonds is not subject to United States federal income tax if the holder of the Bonds is a corporation organized under the laws of Puerto Rico and such interest is not effectively connected with the conduct of a trade or business in the United States by such corporation, such corporation is not a foreign personal holding company, a controlled foreign corporation or a passive foreign investment company under the U.S. Code, and such corporation is not treated as a domestic corporation for the purposes of the U.S. Code.

In connection with the foregoing statements about certain United States tax consequences arising from the ownership of, receipt or accrual of interest on, or the disposition of the Bonds, be advised that pursuant to the U. S. Internal Revenue Service Circular No. 230:

(1) these tax statements are not intended or written to be used, and cannot be used by any taxpayer, for purposes of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service,

(2) these statements were written in connection with the promotion or marketing of the Bonds; and

(3) each prospective purchaser of the Bonds should seek tax advice from an independent tax advisor based on its particular circumstances.

This opinion is limited to the above, and we express no other opinion regarding Puerto Rico or United States tax consequences arising from ownership or disposition of the Bonds.

This letter is furnished by us solely for the benefit of the Corporation and the holders from time to time of the Bonds and may not be relied upon by any other person.

We hereby consent to the inclusion of this opinion as *Appendix D* to the Official Statement of the Corporation dated June 25, 2008 in connection with the Bonds. We further consent to the reference made to us under the captions “Tax Matters - Puerto Rico Tax Considerations” and “Legal Matters” in said Official Statement.

We express no opinion regarding any other Federal, Commonwealth or state tax consequences with respect to the Bonds. We are rendering our opinion under existing statutes and court decisions as of the issue date, and assume no obligation to update our opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. We express no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the inclusion of interest on the Bonds in gross income for Federal income tax purposes, or under state, Commonwealth or local tax law.

Respectfully submitted,

**BOOK-ENTRY SYSTEM****The Depository Trust Company**

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee). One fully-registered Bond certificate will be issued for each stated maturity of the Bonds, each in the aggregate principal amount (initial principal amount in the case of the Capital Appreciation Bonds) of such maturity, and will be deposited with DTC. SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE BONDS, AS NOMINEE FOR DTC, REFERENCES HEREIN TO BONDHOLDERS OR OWNERS OF THE BONDS (OTHER THAN UNDER THE CAPTION "TAX MATTERS") SHALL MEAN CEDE & CO. AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS.

DTC, the world's largest depository, 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, as amended (the "Exchange Act"). DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's Participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has S&P's highest rating; AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission ("SEC"). More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

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

To facilitate subsequent transfers, the Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds 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.

Redemption notices shall be sent to DTC. If less than all of the Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

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

Redemption proceeds, distributions, and dividend payments on the Bonds will be made to Cede & Co., 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 Corporation or the Trustee on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee, or the Corporation, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Corporation or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

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

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

NONE OF THE CORPORATION, THE TRUSTEE OR THE PRINCIPAL WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DIRECT PARTICIPANTS, INDIRECT PARTICIPANTS OR ANY BENEFICIAL OWNER WITH RESPECT TO (I) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY PARTICIPANT OR INDIRECT PARTICIPANT; (II) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OF, OR PREMIUM, IF ANY, OR INTEREST ON, THE BONDS; (III) ANY NOTICE WHICH IS PERMITTED OR REQUIRED TO BE GIVEN TO BONDHOLDERS; (IV) ANY CONSENT GIVEN BY DTC OR OTHER ACTION TAKEN BY DTC AS A BONDHOLDER; OR (V) THE SELECTION BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE BONDS.

**APPENDIX F**

**TABLE OF COMPOUNDED AMOUNTS FOR  
CAPITAL APPRECIATION BONDS**

<b>Date</b>	<b>CABS Due 2024</b>	<b>CABS Due 2025</b>	<b>CABS Due 2026</b>	<b>CABS Due 2027</b>	<b>CABS Due 2031</b>	<b>CABS Due 2032</b>	<b>CABS Due 2033</b>	<b>CABS Due 2034</b>	<b>CABS Due 2035</b>	<b>CABS Due 2036</b>
06/26/2008	\$1,862.40	\$1,751.60	\$1,647.40	\$1,549.30	\$1,212.20	\$1,140.10	\$1,072.20	\$1,008.40	\$ 948.40	\$ 892.00
08/01/2008	1,873.60	1,762.10	1,657.20	1,558.60	1,219.50	1,146.90	1,078.60	1,014.50	954.10	897.30
02/01/2009	1,931.90	1,817.00	1,708.90	1,607.20	1,257.40	1,182.60	1,112.20	1,046.10	983.80	925.30
08/01/2009	1,992.10	1,873.60	1,762.10	1,657.20	1,296.60	1,219.50	1,146.90	1,078.60	1,014.50	954.10
02/01/2010	2,054.20	1,931.90	1,817.00	1,708.90	1,337.00	1,257.40	1,182.60	1,112.20	1,046.10	983.80
08/01/2010	2,118.20	1,992.10	1,873.60	1,762.10	1,378.60	1,296.60	1,219.50	1,146.90	1,078.60	1,014.50
02/01/2011	2,184.10	2,054.20	1,931.90	1,817.00	1,421.60	1,337.00	1,257.40	1,182.60	1,112.20	1,046.10
08/01/2011	2,252.20	2,118.20	1,992.10	1,873.60	1,465.90	1,378.60	1,296.60	1,219.50	1,146.90	1,078.60
02/01/2012	2,322.30	2,184.10	2,054.20	1,931.90	1,511.50	1,421.60	1,337.00	1,257.40	1,182.60	1,112.20
08/01/2012	2,394.70	2,252.20	2,118.20	1,992.10	1,558.60	1,465.90	1,378.60	1,296.60	1,219.50	1,146.90
02/01/2013	2,469.30	2,322.30	2,184.10	2,054.20	1,607.20	1,511.50	1,421.60	1,337.00	1,257.40	1,182.60
08/01/2013	2,546.20	2,394.70	2,252.20	2,118.20	1,657.20	1,558.60	1,465.90	1,378.60	1,296.60	1,219.50
02/01/2014	2,625.50	2,469.30	2,322.30	2,184.10	1,708.90	1,607.20	1,511.50	1,421.60	1,337.00	1,257.40
08/01/2014	2,707.30	2,546.20	2,394.70	2,252.20	1,762.10	1,657.20	1,558.60	1,465.90	1,378.60	1,296.60
02/01/2015	2,791.60	2,625.50	2,469.30	2,322.30	1,817.00	1,708.90	1,607.20	1,511.50	1,421.60	1,337.00
08/01/2015	2,878.60	2,707.30	2,546.20	2,394.70	1,873.60	1,762.10	1,657.20	1,558.60	1,465.90	1,378.60
02/01/2016	2,968.20	2,791.60	2,625.50	2,469.30	1,931.90	1,817.00	1,708.90	1,607.20	1,511.50	1,421.60
08/01/2016	3,060.70	2,878.60	2,707.30	2,546.20	1,992.10	1,873.60	1,762.10	1,657.20	1,558.60	1,465.90
02/01/2017	3,156.00	2,968.20	2,791.60	2,625.50	2,054.20	1,931.90	1,817.00	1,708.90	1,607.20	1,511.50
08/01/2017	3,254.30	3,060.70	2,878.60	2,707.30	2,118.20	1,992.10	1,873.60	1,762.10	1,657.20	1,558.60
02/01/2018	3,355.70	3,156.00	2,968.20	2,791.60	2,184.10	2,054.20	1,931.90	1,817.00	1,708.90	1,607.20
08/01/2018	3,460.30	3,254.30	3,060.70	2,878.60	2,252.20	2,118.20	1,992.10	1,873.60	1,762.10	1,657.20
02/01/2019	3,568.00	3,355.70	3,156.00	2,968.20	2,322.30	2,184.10	2,054.20	1,931.90	1,817.00	1,708.90
08/01/2019	3,679.20	3,460.30	3,254.30	3,060.70	2,394.70	2,252.20	2,118.20	1,992.10	1,873.60	1,762.10
02/01/2020	3,793.80	3,568.00	3,355.70	3,156.00	2,469.30	2,322.30	2,184.10	2,054.20	1,931.90	1,817.00
08/01/2020	3,912.00	3,679.20	3,460.30	3,254.30	2,546.20	2,394.70	2,252.20	2,118.20	1,992.10	1,873.60
02/01/2021	4,033.80	3,793.80	3,568.00	3,355.70	2,625.50	2,469.30	2,322.30	2,184.10	2,054.20	1,931.90
08/01/2021	4,159.50	3,912.00	3,679.20	3,460.30	2,707.30	2,546.20	2,394.70	2,252.20	2,118.20	1,992.10
02/01/2022	4,289.00	4,033.80	3,793.80	3,568.00	2,791.60	2,625.50	2,469.30	2,322.30	2,184.10	2,054.20
08/01/2022	4,422.70	4,159.50	3,912.00	3,679.20	2,878.60	2,707.30	2,546.20	2,394.70	2,252.20	2,118.20
02/01/2023	4,560.40	4,289.00	4,033.80	3,793.80	2,968.20	2,791.60	2,625.50	2,469.30	2,322.30	2,184.10
08/01/2023	4,702.50	4,422.70	4,159.50	3,912.00	3,060.70	2,878.60	2,707.30	2,546.20	2,394.70	2,252.20
02/01/2024	4,849.00	4,560.40	4,289.00	4,033.80	3,156.00	2,968.20	2,791.60	2,625.50	2,469.30	2,322.30
08/01/2024	5,000.00	4,702.50	4,422.70	4,159.50	3,254.30	3,060.70	2,878.60	2,707.30	2,546.20	2,394.70
02/01/2025	-	4,849.00	4,560.40	4,289.00	3,355.70	3,156.00	2,968.20	2,791.60	2,625.50	2,469.30
08/01/2025	-	5,000.00	4,702.50	4,422.70	3,460.30	3,254.30	3,060.70	2,878.60	2,707.30	2,546.20
02/01/2026	-	-	4,849.00	4,560.40	3,568.00	3,355.70	3,156.00	2,968.20	2,791.60	2,625.50
08/01/2026	-	-	5,000.00	4,702.50	3,679.20	3,460.30	3,254.30	3,060.70	2,878.60	2,707.30
02/01/2027	-	-	-	4,849.00	3,793.80	3,568.00	3,355.70	3,156.00	2,968.20	2,791.60
08/01/2027	-	-	-	5,000.00	3,912.00	3,679.20	3,460.30	3,254.30	3,060.70	2,878.60
02/01/2028	-	-	-	-	4,033.80	3,793.80	3,568.00	3,355.70	3,156.00	2,968.20
08/01/2028	-	-	-	-	4,159.50	3,912.00	3,679.20	3,460.30	3,254.30	3,060.70



Date	CABS Due 2024	CABS Due 2025	CABS Due 2026	CABS Due 2027	CABS Due 2031	CABS Due 2032	CABS Due 2033	CABS Due 2034	CABS Due 2035	CABS Due 2036
02/01/2029	-	-	-	-	4,289.00	4,033.80	3,793.80	3,568.00	3,355.70	3,156.00
08/01/2029	-	-	-	-	4,422.70	4,159.50	3,912.00	3,679.20	3,460.30	3,254.30
02/01/2030	-	-	-	-	4,560.40	4,289.00	4,033.80	3,793.80	3,568.00	3,355.70
08/01/2030	-	-	-	-	4,702.50	4,422.70	4,159.50	3,912.00	3,679.20	3,460.30
02/01/2031	-	-	-	-	4,849.00	4,560.40	4,289.00	4,033.80	3,793.80	3,568.00
08/01/2031	-	-	-	-	5,000.00	4,702.50	4,422.70	4,159.50	3,912.00	3,679.20
02/01/2032	-	-	-	-	-	4,849.00	4,560.40	4,289.00	4,033.80	3,793.80
08/01/2032	-	-	-	-	-	5,000.00	4,702.50	4,422.70	4,159.50	3,912.00
02/01/2033	-	-	-	-	-	-	4,849.00	4,560.40	4,289.00	4,033.80
08/01/2033	-	-	-	-	-	-	5,000.00	4,702.50	4,422.70	4,159.50
02/01/2034	-	-	-	-	-	-	-	4,849.00	4,560.40	4,289.00
08/01/2034	-	-	-	-	-	-	-	5,000.00	4,702.50	4,422.70
02/01/2035	-	-	-	-	-	-	-	-	4,849.00	4,560.40
08/01/2035	-	-	-	-	-	-	-	-	5,000.00	4,702.50
02/01/2036	-	-	-	-	-	-	-	-	-	4,849.00
08/01/2036	-	-	-	-	-	-	-	-	-	5,000.00