# COMMONWEALTH OF PUERTO RICO

## QUARTERLY REPORT DATED MAY 7, 2015

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## INTRODUCTION

This Quarterly Report of the Commonwealth of Puerto Rico (the "Commonwealth") is dated as of May 7, 2015, and is intended to update certain information included in the Commonwealth's Financial Information and Operating Data Report dated October 30, 2014 (the "Base Commonwealth Report"). The Base Commonwealth Report, as supplemented by this Quarterly Report, is referred to as the "Commonwealth Report."

This Quarterly Report should be read in conjunction with the information contained in the Base Commonwealth Report. Unless otherwise stated, the information included herein is current as of March 31, 2015. The Commonwealth is not updating the Commonwealth Report in its entirety. Therefore, there could be changes to the information set forth in the Base Commonwealth Report that are not reflected in this Quarterly Report. You should not assume that the information in this Quarterly Report and the other documents that form part of the Base Commonwealth Report is accurate as of any date other than the respective dates as of which such information is presented in such reports.

On April 21, 2015, the Commonwealth filed a Notice of Failure to File Annual Report (the "Notice") with the Municipal Securities Rulemaking Board, through the Electronic Municipal Market Access System ("EMMA"). The Notice states that the Commonwealth will not provide its audited financial statements for fiscal year 2014 (the "2014 Financial Statements") by the filing deadline of May 1, 2015, as required by its continuing disclosure undertakings made in connection with its bond issuances, and that the Commonwealth expects to file its 2014 Financial Statements by July 31, 2015. In connection with the process of finalizing its 2014 Financial Statements, additional information may come to light that may cause further material changes to the information set forth in the Commonwealth Report, including information about the Commonwealth's preliminary and unaudited revenues, expenditures and budget deficit for fiscal year 2014.

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

The Commonwealth Report provides an overview of the fiscal and economic condition of the Commonwealth, including historical revenues and expenditures of its General Fund (which is the primary operating fund of the Commonwealth). Although the Commonwealth Report discusses information about certain public corporations and government instrumentalities of the Commonwealth, the Commonwealth Report does not, and is not intended to, provide detailed information as to the financial condition of such public corporations and instrumentalities. The Commonwealth Report also does not provide, and is not intended to provide, any information regarding the financial condition of the Commonwealth's 78 municipalities.

## Forward-Looking Statements

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

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

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

## RECENT EVENTS

### Preliminary General Fund Budgetary Revenues for the First Ten Months of Fiscal Year 2015

Preliminary General Fund revenues for the first ten months of fiscal year 2015 were approximately $7.335 billion, an increase of $61.6 million when compared to the same period in the prior fiscal year, but $250.6 million less than the originally estimated revenues for the period. See "FISCAL CONDITION − Preliminary General Fund Revenues for First Ten Months of Fiscal Year 2015."

### Projected Budget Deficit for Fiscal Year 2015

The Government projects that it will close fiscal year 2015 with a budget deficit of $191million. This is the result of an estimated revenue shortfall of $651 million that is expected to be partially offset with certain new revenue measures, some of which have already been approved and implemented, estimated to generate approximately $335 million (of which $150 million have already been collected) and $125 million in cuts in budgetary appropriations already implemented by the Office of Management and Budget ("OMB"). See "FISCAL CONDITION – Preliminary General Fund Revenues for the First Ten Months of Fiscal Year 2015 and Expenditures for the First Nine Months of Fiscal Year 2015; Projected Budget Deficit for Fiscal Year 2015."

### Tax Reform

House of Representatives Bill 2329 (the "Tax Reform Bill"), introduced on February 11, 2015, proposed a comprehensive transformation of the Puerto Rico tax system. The Tax Reform Bill would have enacted the "Commonwealth of Puerto Rico Tax System Transformation Act," also known as the Internal Revenue Code of 2015, with the goal of establishing a more simple, fair, effective, broad-based, and easier to supervise tax system that promotes economic development, reduces income tax rates for individuals and corporations, and transitions the sales and use tax into a value added tax ("VAT"). The Tax Reform Bill proposed a 16% VAT in lieu of the existing Sales and Use Tax ("SUT") and eliminated certain exceptions currently applicable to the SUT in order to broaden the tax base of the consumption tax. The Tax Reform Bill also reduced income tax rates significantly and provided regressivity relief to eligible consumers in order to offset all or part of the economic impact of the increase in the consumption tax rate under the VAT on such individuals. The Treasury Department had projected that the Tax Reform Bill would have generated approximately $1.2 billion in additional recurring revenues to the General Fund.

The Tax Reform Bill was subject to intense debate in the Legislative Assembly with respect to some of its salient features, such as the 16% VAT. On April 29, 2015, a substitute bill was filed at the House of Representatives. This bill renamed the value added tax as a goods and services tax and proposed substitute rates of 13% and 10% for different activities. The bill was voted down by the House of Representatives the same day by a vote of 28 to 22. In order to submit a balanced budget for fiscal year 2016, the Executive Branch is considering significant expense reduction measures and is evaluating alternate revenue measures. It is currently uncertain whether such measures will be successful.

**Third-Party Liquidity Analysis of the Commonwealth for the Balance of Fiscal Year 2015 and Fiscal Year 2016**

GDB, in its role as fiscal agent to the Commonwealth and its instrumentalities, has hired Conway MacKenzie, Inc. ("Conway"), a U.S.-based consulting firm, to perform a liquidity analysis of the Commonwealth, assist with the implementation of measures to improve cash management and forecasting procedures, and provide assistance to the Puerto Rico Treasury Department (the "Treasury Department" or "Treasury") in the development of short and medium-term cash flow projections. Conway has also performed a limited review of certain other Commonwealth funds and component units, and this limited review has now been expanded to include a more detailed review of such funds and units.

As part of the engagement, Conway has provided liquidity projections for the remainder of the current fiscal year and the following fiscal year of the Commonwealth's cash balance in the Treasury Department's Single Account (the "Concentration Account"), in which the Treasury Department deposits and disburses amounts related to all funds managed by Treasury, including, among others, receipts from taxes and charges for services, collections made on behalf of certain component units, receipts of most Federal funds, and net receipts from new debt issuances and pension contributions and disbursements of pensions benefits for the three principal retirement systems. It is important to note that Conway's analysis was limited to funds available to the Treasury Department in its Concentration Account at GDB and did not factor other potential sources of liquidity available to the Commonwealth, such as cash in the Commonwealth's depositary accounts other than the Concentration Account (including accounts holding funds for capital projects of the Commonwealth), agency deposits at third party financial institutions and cash and other liquid assets held by GDB.

Conway's work product is preliminary, ongoing and subject to review by GDB and the Treasury Department and is expected to change due to, among other things, such review, potential legislative and administrative initiatives and actual results for fiscal year 2015.

For a more extensive discussion of Conway's work, see "FISCAL CONDITION - Third-Party Liquidity Analysis of the Commonwealth for the Balance of Fiscal Year 2015 and Fiscal Year 2016."

**Engagement of Economists to Conduct Analysis of the Commonwealth's Economic and Financial Stability and Growth Prospects**

On February 5, 2015, Dr. Anne O. Krueger, Dr. Ranjit S. Teja and Dr. Andrew Wolfe (the "Former IMF economists"), each of whom has previously occupied senior executive positions at the International Monetary Fund ("IMF"), were engaged at GDB's request by its counsel, to analyze the Commonwealth's economic and financial stability and growth prospects. The analysis to be delivered will be divided into two stages: (i) an assessment of the probable future performance of the Commonwealth economy and public finances based on current policies, past experience and market conditions, and the risks inherent in the Commonwealth's outlook based on current conditions, and (ii) options to strengthen the Commonwealth's outlook with a particular emphasis on policies to improve economic growth and reduce debt-servicing difficulties. The analysis to be performed is expected to include a public sector debt sustainability analysis similar to that performed by the IMF. GDB expects to receive an initial draft of this analysis in May 2015.

Based on historical and projected fiscal and financial information provided by the Commonwealth, the analysis being prepared by the Former IMF economists will look at a broader concept of the central government and its fiscal balance rather than just the General Fund, in line with IMF practices. It is expected to examine the extent of the potential fiscal financing gaps (i.e., the extent to which total projected expenditures exceed total projected revenues) over the next five years based on current government policies, as well as taking into account potential contingencies, such as the loss of certain federal funds, and the implementation of additional revenue and expenditure reform measures.

Although the analysis is still preliminary and the underlying data used therein is still subject to review by the responsible government officers, the Former IMF economists have shared with GDB initial and preliminary findings of their five-year projected revenue and expense scenarios. Their preliminary findings indicate that there may be substantial fiscal financing gaps in the projected five-year period that may require significant fiscal adjustment beyond that contemplated by the original Tax Reform Bill and currently identified expense initiatives for the fiscal year 2016 General Fund budget. How much of the gap can be closed by fiscal measures will hinge on the political and economic feasibility of the adjustment effort. In the absence of adequate financing alternatives, the inability to close the gap may require the Commonwealth, GDB and other instrumentalities to implement emergency measures as described under "RISK FACTORS." The data and assumptions on which the Former IMF economists have based their preliminary findings remain subject to verification and review, which they expect to carry out in the following weeks.

In preparing their analysis, the Former IMF economists will rely on information provided by the Commonwealth and its instrumentalities and, therefore, these economists are expected to assume no responsibility for the accuracy or completeness of such information. Furthermore, it is expected that the analysis prepared by the Former IMF economists will include estimates and projections based on assumptions about economic growth and other variables that are inherently subject to significant political, economic and other uncertainties. Actual results may vary materially from such estimates and projections.

Dr. Krueger is currently Senior Fellow at the Stanford Center for International Development and Senior Research Professor of International Economics at Johns Hopkins University. She was the World Bank Chief Economist from 1982 to 1986 and the first deputy managing director of the IMF from 2001 to 2006. She has previously served on the faculty of Stanford University, Duke University and the University of Minnesota.

Dr. Teja recently retired from the IMF, where the last position he held was that of Deputy Director, European Department. Dr. Teja worked with the IMF since 1986, and has experience with emerging market crises in Asia (India, Thailand), Europe (Czech Republic) and Latin America (Brazil, Uruguay) and surveillance of large economies (China, US, Spain). He also served as former Senior Adviser to the Managing Director of the IMF.

Dr. Wolfe is currently Adjunct Professorial Lecturer at the School of International Service at American University in Washington D.C. Dr. Wolfe retired in June 2014 from the IMF after 27 years, where he was a senior manager of the Western Hemisphere Department, serving as an economist and advisor to governments throughout Latin America and the Caribbean. He was previously on the faculty of Bowdoin College.

*The Former IMF economists have not participated in the preparation of this Quarterly Report and have no responsibility for its contents. The Former IMF economists are not soliciting or recommending the purchase or sale of securities, or any indications for the purchase or sale of securities, or any other investment decisions.*

**Enactment of Act 1-2015; Proposed PRIFA Bond Issuance**

Act 1-2015, which amends the enabling act of the Puerto Rico Infrastructure Financing Authority ("PRIFA"), Act. No. 44 of June 21, 1988, as amended, and Act No. 1-2011, as amended, also known as the Internal Revenue Code of 2011, imposes a new petroleum products tax and assigns the revenues therefrom to PRIFA to secure the payment of bonds and notes issued by PRIFA. The PRIFA bonds and notes may be guaranteed by the Commonwealth provided the aggregate principal amount of such guaranteed bonds does not exceed $2.95 billion, the nominal annual interest rate does not exceed 8.50% and the maturity does not exceed 30 years.

Based on the provisions of this legislation, PRIFA intends to issue bonds secured by collections of the new petroleum products tax and use the proceeds therefrom to, among other uses, repay loans made by GDB to PRHTA and PRHTA's outstanding variable rate debt obligations ("VRDOs") owned by GDB. As of March 31, 2015, GDB's outstanding loans to PRHTA and outstanding VRDOs totaled approximately $2.080 billion and $200 million, respectively, including accrued interest. The repayment of GDB's outstanding loans to PRHTA and PRHTA's outstanding VRDOs would improve GDB's liquidity and enable GDB, subject to applicable legal restrictions and other competing liquidity needs, to provide liquidity support to the Commonwealth during fiscal year 2016. The success of any future bond issuance by PRIFA remains subject to market conditions and the Commonwealth's ability to meet demands of prospective investors, which include demands for certain covenants and remedies. The Commonwealth cannot provide any assurance that it will be able to accept these or any other request investors may make. In anticipation of such bond issuance, on March 17, 2015, PRIFA issued $245,955,000 of bond anticipation notes, the proceeds of which were used to refinance certain outstanding PRHTA bond anticipation notes and pay related expenses.

The consummation of the transactions contemplated by Act 1-2015 is expected to materially reduce PRHTA's debt and operational burden, potentially improving its financial condition. However, as described above, the consummation of these transactions is subject to significant execution risk.

**Recovery Act and United States Bankruptcy Code Initiative**

On February 6, 2015, the United States District Court for the District of Puerto Rico issued an opinion and order declaring the Puerto Rico Public Corporation Debt Enforcement and

Recovery Act (the "Recovery Act") (which provides a mechanism for certain Commonwealth public corporations, but not the Commonwealth itself, to restructure their obligations) unconstitutional and stating that it was preempted by the United States Bankruptcy Code. The Commonwealth filed an expedited appeal before the United States Court of Appeals for the First Circuit. The parties have filed their briefs and oral arguments were held on May 6, 2015. For a discussion of the Recovery Act, see "FISCAL CONDITION – Enactment of Puerto Rico Public Corporation Debt Enforcement and Recovery Act" in the Base Commonwealth Report.

On February 11, 2015, Puerto Rico Resident Commissioner Pedro Pierluisi introduced a bill in the U.S. Congress (H.R. 870) that would empower the government of Puerto Rico to authorize Puerto Rico municipalities and public corporations to restructure their debt obligations under Chapter 9 of the United States Bankruptcy Code, which currently applies to municipalities and public corporations of the 50 states, but excludes those of Puerto Rico. The Commonwealth and GDB support this amendment to the United States Bankruptcy Code and are lobbying in favor of H.R. 870.

On February 26, 2015, the Subcommittee on Regulatory Reform, Commercial and Antitrust Law of the U.S. House Committee on the Judiciary, chaired by Congressman Tom Marino, held a public hearing to consider H.R. 870. While several members of Congress present at the hearing expressed support for the bill, other members of Congress expressed reservations about making the effects of the bill retroactive (i.e., allowing for the modification of existing indebtedness). Since the date of the hearing, certain holders of debt obligations of the Commonwealth and its instrumentalities have publicly expressed their opposition to the bill and have conducted a media and lobbying effort to prevent its passage. At this time it is unclear if and when the bill will be approved and, if it is approved, whether its effects will be retroactive or not.

**Forbearance Agreements between Puerto Rico Electric Power Authority and Certain Bondholders and Lenders**

On August 14, 2014, the Puerto Rico Electric Power Authority ("PREPA"), which has been experiencing significant financial difficulties, entered into forbearance agreements with certain of its bondholders and bank creditors. Among other things, the banks agreed to extend the maturity of their loans until March 31, 2015, and all bondholders and lenders party to the agreements agreed to forbear from exercising their rights against PREPA resulting from certain specified defaults until March 31, 2015. The forbearance agreements have now been extended on three occasions, currently until June 4, 2015. Pursuant to the last extension agreed to on April 30, 2015, PREPA covenanted to deliver a recovery plan proposal to the forbearing creditors' advisors on or before June 1, 2015. Discussions between PREPA and its creditors are ongoing. To date, no agreement has been reached with the forbearing creditors concerning the terms of a recovery plan, and there can be no assurance that PREPA and the forbearing creditors will reach agreement on a recovery plan. See "PUBLIC CORPORATIONS – Electric Power Authority" in the Base Commonwealth Report.

**Amendment to Puerto Rico Aqueduct and Sewer Authority ("PRASA") Credit Agreement**

On March 3, 2015, PRASA executed an amendment to the Credit Agreement, originally executed on October 24, 2013, by and among PRASA, Oriental Bank and Banco Popular de Puerto Rico, whereby the banks agreed to extend the maturity date on $200 million of loans incurred under the Credit Agreement through May 29, 2015. Concurrently with the execution of the amendment, PRASA paid the banks $40 million of the principal due and agreed to make two additional principal payments of $5 million each on April 1 and May 1, 2015, which have been made. These loans constitute senior indebtedness under PRASA's Master Agreement of Trust, ranking on parity with PRASA's senior bonds and collateralized with a gross pledge of PRASA's revenues. In the absence additional extensions by Oriental Bank and Banco Popular or a refinancing of these loans, commencing on May 1, the trustee under the Master Agreement of Trust will set aside for the benefit of these lenders, from PRASA's gross revenues, the full amount of principal due on these loans on May 29, 2015. Since PRASA's revenues during such period are expected to be insufficient to satisfy in full the principal amount of these loans, on the maturity date the trustee is expected to draw on moneys in various PRASA accounts that constitute collateral under the Master Agreement of Trust, including PRASA's Rate Stabilization Fund. This set-aside of gross revenues prior to the maturity of these loans, together with the application of funds in the other accounts under the Master Agreement of Trust to the repayment of these loans, would materially affect PRASA's liquidity and, as a consequence, its ability to perform essential public services. Furthermore, the use of all or a portion of the funds in the Rate Stabilization Fund to pay the principal amount of these loans may require PRASA to increase its utility rates on or prior to July 31, 2016 (significantly earlier than previously expected) to satisfy its covenants under Master Agreement of Trust.

PRASA is currently preparing to issue bonds, subject to market conditions, the proceeds of which would be used to repay the bank debt described above and to fund other needs. PRASA is also evaluating other liquidity alternatives.

**Puerto Rico Metropolitan Bus Authority**

On March 31, 2015, the Puerto Rico Metropolitan Bus Authority ("PRMBA") executed an amendment to its loan facility with Scotiabank de Puerto Rico whereby the local commercial bank agreed to extend the maturity date on a $30 million loan to PRMBA from March 31, 2015 until April 30, 2015, which has now been further extended to May 31, 2015. The extension of the maturity date has been the only change to the original loan facility. The line of credit is secured by approximately $10 million in cigarette tax revenues pledged to PRMBA. This loan facility is expected to be refinanced in full with proceeds of the proposed PRIFA bond issuance.

**Health Insurance Administration Fiscal Situation**

The Puerto Rico Health Insurance Administration's ("PRHIA") transition from a third party administrator model to a managed care organization model has exacerbated PRHIA's liquidity needs because, in the latter model, it is customary to pay related premiums during the first days of each month. This requirement, coupled with the need to fund legacy claims under the Third Party Administrator model, results in a financing need of approximately $150 million. If PRHIA is unable to secure funding or financing for this financing gap and/or if the Commonwealth's financial situation precludes it from continuing supporting the Commonwealth health insurance plan, PRHIA might be unable to fulfill its financial and contractual obligations. In order to ensure continuity of services, PRHIA reached a preliminary agreement with the five private insurance providers, whereby PRHIA will be paying throughout the month the premiums owed to the insurers (as opposed to paying the entire amount during the first days of the month).

PRHIA is facing other challenges, including a substantial reduction in federal funding (absent Congressional action) in the next few years. See "FISCAL CONDITION – Financial Condition of Selected Component Units – PRHIA" And "RISK FACTORS – The Commonwealth's healthcare costs represent a very high percentage of its budgetary expenditures, and the Commonwealth may be unable to continue to fund such healthcare costs."

**Downgrade of Bond Ratings**

Since February of 2014, the credit ratings of the Commonwealth's general obligation bonds and Commonwealth guaranteed bonds, as well as the ratings of most of the Commonwealth's public corporations, have been lowered (more than once in most cases) to non-investment grade by Moody's, S&P, and Fitch. According to the ratings agencies, further downgrades are possible. These ratings and outlooks reflect only the opinions of such rating agencies and an explanation of the significance of such ratings may be obtained only from the relevant rating agency.

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

| Public Corporation | S&P | Moody's | Fitch |
|---|---|---|---|
| Commonwealth of Puerto Rico (General Obligations) | CCC+ | Caa1 | B |
| Government Development Bank | CCC | Caa1 | |
| COFINA | | | |
| Senior Lien | CCC+ | B3 | B |
| First Subordinate Lien | CCC+ | Caa1 | B |
| PR Electric Power Authority | CCC- | Caa3 | CC |
| PR Highways and Transportation Authority | | | |
| Highways Revenue Bonds | CCC+ | Caa2 | |
| Senior Transportation Revenue Bonds | CCC+ | Caa2 | |
| Subordinate Transportation Revenue Bonds | CCC+ | Caa2 | |
| PR Aqueduct and Sewer Authority | | | |
| Revenue Bonds | CCC+ | Caa1 | B |
| Guaranteed Bonds | CCC+ | Caa1 | B |
| PR Public Buildings Authority | CCC+ | Caa1 | B |
| PR Employees Retirement System | CCC+ | Caa2 | B |
| PR Public Finance Corporation (Commonwealth Appropriation Bonds) | CCC+ | Caa2 | |
| PR Municipal Finance Agency | CCC+ | Caa1 | |
| PR Convention Center District Authority | CCC+ | Caa2 | |
| PR Industrial Development Company | CCC+ | B3 | |
| PR Infrastructure Financing Authority | | | |
| Special Tax Revenue Bonds | CCC+ | Caa2 | |
| PR Ports Authority Project | B- | Caa1 | |
| University of Puerto Rico | | | |
| Revenue Bonds | CCC+ | Caa2 | |
| AFICA – Plaza Universitaria Project | CCC+ | Caa3 | |

**Failure to File Commonwealth Consolidated Annual Financial Statements by May 1 Deadline**

The Commonwealth was not able to file its audited financial statements for fiscal year 2014 by the May 1, 2015 deadline, as required by its continuing disclosure undertakings, principally as a result of (i) the implementation of new governmental accounting pronouncements; (ii) the requirement of certain additional audit procedures and management analyses at the Puerto Rico Police Department, which is part of the primary government reporting entity; (iii) delays in the issuance of the audited financial statements of the Commonwealth's three retirement systems, which are fiduciary component units of the Commonwealth, and of certain of its blended and discretely presented component units; and (iv) the requirement of additional analysis related to the liquidity risk and uncertainties of the Commonwealth and certain of its discretely presented component units. The Commonwealth's financial reporting entity under government accounting standards consists of the primary government, seven blended component units, 45 discretely presented component units and three fiduciary component units. Component units are generally separate legal entities that issue their own audited financial statements. After they do so, these financial statements are incorporated into the Commonwealth's financial statements. As a result, delays in the issuance of the audited financial statements of these component units can cause a delay in the issuance of the Commonwealth's audited financial statements. The Commonwealth expects to file its audited financial statements for fiscal year 2014 by July 31, 2015. However, a delay in the resolution of the pending matters detailed above, may further delay the issuance of the Commonwealth's financial statements.

**Proposed Amendments to GDB Organic Act**

On April 8, 2015, a bill was filed to amend GDB's Organic Act, which is supported by both the Governor and GDB. The proposed bill includes, among other matters, safeguards, restrictions and best practices in the lending functions of GDB. The bill prohibits GDB from lending to government entities (1) that are in default on any payment to GDB or (2) in the case of entities other than the Commonwealth, if the principal outstanding on all loans of that governmental entity with GDB exceed 5% of GDB's total loan portfolio. Furthermore, the bill provides that the use of proceeds of new GDB loans are limited to funding capital expenditures or working capital needs (in such case, with a maturity of one year or less), unless expressly authorized by law. In addition, the bill requires GDB to meet certain capital to assets, loan to deposit and other ratios in order to continue granting loans.

**Proposed Amendment to the Commonwealth Constitution**

On March 15, 2015, a bill was filed in the Puerto Rico House of Representatives that seeks to amend the Puerto Rico constitution to limit the constitutional protections afforded to the holders of Commonwealth general obligation debt. This bill is not supported by the legislative leadership and has been publicly opposed by the Governor and GDB.

**Doral Financial Corporation Litigation**

On June 5, 2014, Doral Financial Corporation ("Doral") and certain of its subsidiaries filed a lawsuit against the Commonwealth and the Treasury Department seeking a declaratory judgment regarding the validity of a 2012 closing agreement between Doral and the Treasury Department, which provided for a refund of approximately $230 million to Doral, payable over a five-year period, which closing agreement had been declared null and void by the Treasury Department. On October 10, 2014, the trial court ruled in favor of Doral, holding that the closing agreement was valid. However, on February 25, 2015, the Court of Appeals reversed the ruling, finding that the closing agreement was null and void. On February 27, 2015, the Puerto Rico Supreme Court declined the petition for review filed by Doral.

On March 11, 2015, Doral filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code in New York. At this time, it is not clear if Doral will attempt to make any other tax reimbursement claims against the Commonwealth.

## RISK FACTORS

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

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

***The Commonwealth may need to implement administrative and emergency measures in fiscal year 2016 and thereafter, which could include a moratorium on the payment of debt service or debt adjustment.***

The Commonwealth may lack sufficient resources to fund all necessary governmental programs and services as well as meet debt service obligations for fiscal year 2016. Since the Tax Reform Bill was not approved, the Executive Branch is considering significant expense reduction measures in addition to those already identified and is evaluating alternate revenues measures in order to submit a balanced budget for fiscal year 2016. It is currently uncertain whether such measures will be successful. In addition, in such an event, the Commonwealth may be forced to take emergency measures. These could include administrative measures, such as those being implemented for fiscal year 2015, and those adopted to reduce appropriations at the end of fiscal year 2014 that give effect to the "priority norms" established by law for the disbursement of public funds when available Commonwealth resources are insufficient to cover all appropriations. These measures could also include a moratorium on the payment of debt service, a debt adjustment, or the utilization for the payment of the Commonwealth's debt service of certain taxes and other revenues previously assigned by law to certain public corporations to secure their indebtedness.

The Commonwealth (like each of the states) is not currently eligible to seek relief under Chapter 9 of the United States Bankruptcy Code. The Commonwealth also is not currently eligible to seek relief under the Recovery Act enacted by the Commonwealth and discussed in the Base Commonwealth Report under "FISCAL CONDITION – Enactment of the Puerto Rico

Public Corporation Debt Enforcement and Recovery Act." In the future, however, the United States Congress or the Legislative Assembly could enact legislation (subject to applicable constitutional limitations), including an amendment to the Recovery Act, that entitles the Commonwealth to seek a debt adjustment, moratorium or other remedy that affects the rights of its creditors.

***If the proposed PRIFA bond issuance or an alternative financing transaction is not consummated, the financial condition and liquidity of the Commonwealth and GDB would suffer materially and adversely and the Commonwealth, GDB and other instrumentalities may need to implement emergency measures, which could include a moratorium on the payment of debt service, a debt adjustment or other actions affecting creditors' rights.***

The Commonwealth's and GDB's liquidity is significantly strained and, absent the consummation of the PRIFA bond issuance or an alternative financing transaction, their remaining liquidity is projected to be depleted in the first quarter of fiscal year 2016. See "RECENT EVENTS- Third-Party Liquidity Analysis of the Commonwealth for the Balance of Fiscal Year 2015 and Fiscal Year 2016," and "FISCAL CONDITION- GDB Funding and Liquidity". As described under "RECENT EVENTS - Enactment of Act 1-2015; Proposed PRIFA Bond Issuance," the proposed PRIFA bond issuance, if consummated in the amounts contemplated, would provide significant new liquidity to GDB and would, in turn, enable GDB to provide liquidity support to the Commonwealth during fiscal year 2016. In the absence of such bond issuance, an alternative financial transaction or other emergency liquidity enhancing or preservation measures, GDB is currently projected to have insufficient liquidity to meet its legal reserve requirement by the first quarter of fiscal year 2016 and may be unable to support the operations and liquidity needs of the Commonwealth, its public corporations and instrumentalities and municipalities. In such a scenario, the Commonwealth may also be unable to obtain intra-year short-term financing for fiscal year 2016 through the issuance of Tax Revenue Anticipation Notes ("TRANs"). The Commonwealth currently projects that absent TRANs financing, the Commonwealth would deplete its cash resources in full during the first quarter of fiscal year 2016, even after considering the implementation of extraordinary short-term administrative measures to conserve cash. As a result, the failure to consummate the proposed PRIFA bond issuance or an alternative financing transaction would likely cause the Commonwealth, GDB and other instrumentalities to be unable to continue funding all governmental programs and services as well as debt service obligations on a timely manner. Since the Commonwealth will seek to maintain essential government operations, even during a period of government-wide limited liquidity, the Commonwealth may seek to implement emergency measures, which could include administrative measures to reduce appropriations, a moratorium on the payment of debt service, a debt adjustment for the Commonwealth, GDB and other instrumentalities, or the payment of the Commonwealth's debt service with certain taxes and other revenues previously assigned by law to certain public corporations to secure their indebtedness.

Certain prospective purchasers of the proposed PRIFA bonds have made a number of requests as a condition to their willingness to purchase such bonds, including certain covenants and remedies in the event of a default. There is no assurance that the PRIFA bond issuance will be completed or that the Commonwealth will be in a position to accept investors requests in order to facilitate the execution of the transaction. Moreover, there is no assurance that, if completed, the PRIFA bond issuance will produce the expected proceeds or that such proceeds will be sufficient to operate the government for a particular period of time.

***If the Commonwealth consummates the proposed PRIFA bond issuance or an alternative financing, its public sector debt and its annual debt service obligations would increase, while only providing a limited liquidity bridge for fiscal year 2016 if it is not accompanied by a comprehensive fiscal adjustment plan.***

The Commonwealth faces several challenges to achieving a balanced budget for fiscal year 2016 and subsequent fiscal years. See "FISCAL CONDITION – Fiscal Year 2016 Budget." Although the proceeds of the proposed PRIFA transaction would be used to refinance existing obligations of PRIFA and PRHTA, the consummation of the proposed PRIFA bond issuance is likely to increase the outstanding principal amount of the Commonwealth's public sector debt. Furthermore, the proposed PRIFA transaction is expected to materially increase the principal amount of bonds outstanding guaranteed by the Commonwealth's full faith and credit. Although payable from the newly established petroleum products tax revenue stream, the transaction will result in additional annual debt service obligations for the Commonwealth and its instrumentalities as a whole. Even if the proposed PRIFA transaction is consummated in the maximum amounts contemplated by the authorizing law, the additional liquidity expected to be provided by such transaction is unlikely to be able provide sufficient liquidity to the Commonwealth and its instrumentalities (through GDB) beyond fiscal year 2016. In the event the TRANs financing is not secured for fiscal year 2016 and the Commonwealth suffers from material deficits for fiscal year 2015 or fiscal year 2016, the PRIFA bond issuance may not provide enough liquidity to allow GDB to support the Commonwealth and its instrumentalities for the entirety of fiscal year 2016. As a result, unless accompanied by a comprehensive fiscal adjustment plan that seeks to materially reduce projected financing needs, the proposed PRIFA bond issuance or an alternative financing will not be sufficient to address the government's short and medium term liquidity needs.

***The Commonwealth's liquidity during the balance of fiscal year 2015 and throughout fiscal year 2016 may be significantly impaired. As a result, it may be unable to honor all of its obligations as they come due*.**

The Commonwealth's liquidity has been adversely affected by lower-than-projected revenues, recent ratings downgrades, the significant increase in credit spreads for obligations of the Commonwealth and its instrumentalities, the limited market access experienced by the Commonwealth and its instrumentalities, and the significant reduction of liquidity in the local Puerto Rico capital markets.

The majority of the Commonwealth's General Fund revenues are received in the second half of the Commonwealth's fiscal year (January 1 through June 30), while expenditures from the General Fund occur more evenly throughout the fiscal year. The Commonwealth customarily addresses this timing difference by issuing TRANs which are then repaid when the bulk of the tax revenues are received in the second half of the fiscal year. In addition, the Treasury Department follows the practice of pooling its cash accounts to meet current operating requirements. The pooled cash includes funds that are collected by the Treasury Department as a custodial agent and have to be remitted to various public corporations, including GDB. The Commonwealth has ended the last several fiscal years with a book overdraft on its cash balance, which has been covered with the proceeds from the issuance of bonds, loans and TRANs, delays on payments to suppliers, taxpayers and component units of the government, and the use of restricted funds within its pooled cash accounts. As of March 31, 2015, such bank cash balance was $90.6 million (excluding the funds aside for general obligation debt service), and the preliminary overdraft on its cash balance on a book basis was approximately $193 million. As of April 30, 2015, the Commonwealth concentration bank cash balance was $146 million (excluding the amount set-aside for general obligation debt service). The book overdraft as of April 30, 2015 has not been determined by the Treasury Department. However, it is expected to be close to or higher than the amount reported as of March 31, 2015. Actual income tax refunds claimed, processed and unpaid as of April 30, 2015 were approximately $225 million.

On December 11, 2014, GDB provided a short-term credit facility of $100 million to the Treasury Department pursuant to Act 164-2001. As of April 30, 2015, $25 million remain unused under that facility. The Treasury Department anticipates that it will need to draw the remaining balance of the facility during the current fiscal year. Any additional short-term financings from GDB will require legislative approval.

During the current fiscal year, unfavorable economic conditions have continued to result in lower-than-estimated revenues. The Commonwealth faces in the remaining months of this fiscal year the maturity of $500 million in TRANs (after taking into consideration payments made in April 2015) plus accrued interest, the payment of approximately $144 million in debt service for general obligations bonds (after taking into consideration payments made in April of 2015) corresponding to the required set-aside deposits to the Redemption Fund required for the last two months of the fiscal year (approximately $72 million per month), payment to GDB of $100 million in principal plus accrued interest on its Act 164-2001 short-term credit facility, and the disbursement of budgeted appropriations for the payment of GDB loans in the principal amount of approximately $161 million. The Commonwealth projects that the above payments will be made as scheduled.

In addition, for the first quarter of fiscal year 2016, the Commonwealth has to pay GDB $300 million in TRANs plus accrued interest which are due on July 10, 2015. The Commonwealth is also required to set aside in the Redemption Fund for its general obligations approximately $276 million in debt service corresponding to the first three months of the fiscal year (approximately of $92 million per month). In addition, $93.7 million of PFC debt service is due on July 15, 2015. On August 1, 2015, GDB has a scheduled principal payment of $140 million on its outstanding bonds.

Neither the Commonwealth nor GDB may be able to honor all of their obligations as they come due nor may the Commonwealth be able to fund all necessary governmental programs and services if it does not have sufficient access to the capital markets or alternative sources of financing to satisfy its liquidity needs, or as a result of the challenges and risk factors identified herein or others not described herein.

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

GDB serves as the principal source of short-term liquidity for the Commonwealth and its instrumentalities. GDB’s liquidity has been adversely affected by, among other things, some of the same factors that have affected the Commonwealth’s liquidity that are described herein, including credit-rating downgrades to non-investment grade level. Although GDB has previously assisted the Commonwealth in satisfying its obligations, GDB is not legally required to provide such assistance and there is no assurance that it will be able to continue to provide such assistance in the future. To the extent that GDB financing is unavailable, the Commonwealth will be required to find other sources of funding in order to meet its obligations. There is no assurance that the Commonwealth will be able to access other sources of financing or funding sufficient at any one time to meet its obligations as they come due. For a more detailed discussion of GDB's liquidity, see "FISCAL CONDITION – GDB Funding and Liquidity."

GDB's fiscal and financial condition depends to a large extent on the repayment of loans made to the Commonwealth and its instrumentalities. GDB may be adversely affected by the inability of the Commonwealth and certain of its instrumentalities that have loans from GDB to fully repay those loans when due. If certain of the Commonwealth's instrumentalities are unable to overcome the challenges described in the Base Commonwealth Report under "RISK FACTORS - *Significant financial and fiscal challenges facing the Commonwealth's instrumentalities may adversely affect the Commonwealth's financial and fiscal condition,*" GDB's financial and fiscal condition may be adversely affected, its balance sheet impaired and its solvency threatened. PRHTA alone owes GDB $2.280 billion (including the VRDOs and accrued interest), which would be repaid in part from the proceeds of the proposed PRIFA bond issuance.

***The Commonwealth faces a number of significant fiscal and economic challenges. It will not be able to achieve a balanced General Fund budget for fiscal year 2015 and may not be able to achieve a balanced General Fund budget in fiscal year 2016 or subsequent fiscal years.***

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

For fiscal year 2015, although the Commonwealth adopted a budget that did not require or provide for additional borrowings to finance budget deficits, it now appears that the projected level of budgeted revenues will not be achieved. The most recent estimate is that the Commonwealth will end fiscal year 2015 with a budget deficit of $191 million. See "FISCAL CONDITION – Preliminary General Fund Revenues for the First Ten Months of Fiscal Year 2015 and Expenditures for the First Nine Months of Fiscal Year 2015; Projected Budget Deficit for Fiscal Year 2015." This estimate depends in the success of various extraordinary one-time revenue and expenditure measures to attempt to reduce a projected revenue shortfall of $651 million, when compared to the original General Fund budget.

For fiscal year 2016, the Commonwealth had expected that the Tax Reform Bill would produce a significant net increase in revenues (after taking into consideration the proposed reduction in income tax rates for certain taxpayers) by broadening the tax base and increasing consumption tax rates, thus allowing the Commonwealth to achieve a balanced budget in fiscal year 2016. Various aspects of the Tax Reform Bill, however, faced opposition from citizens and elected officials and a substitute bill filed on April 29, 2015 was voted down the same day. It is currently uncertain what other revenue raising measures, if any, will be implemented. See "RECENT EVENTS –Tax Reform."

Even if some form of revenue raising legislation were enacted in a form that allows for the adoption of balanced General Fund budget for fiscal year 2016 and beyond, there are a number of risks that could affect the Commonwealth's ability to achieve the desired balance between revenues and expenses. The Commonwealth's ability to operate within a balanced budget depends on a number of factors, some of which are not wholly within its control, including its ability to project accurately its revenues in light of changing circumstances, the performance of the Commonwealth's economy, and the government's ability to reduce and control governmental expenditures, particularly in areas such as education and healthcare where expenses have in the past exceeded the budget. The Commonwealth has frequently failed to meet its revenue and expense projections, and its accounting, payroll and fiscal oversight information systems and processes have deficiencies that adversely affect its ability to forecast expenditures.

The Treasury Department's projections for tax revenues involve many premises and assumptions, the effects of which are beyond its control, such as the impact of external factors and events on the economy that may, in turn, affect tax revenues. The projections also may require the forecasting of new revenue measures with no historical collections experience. In the past, the Commonwealth's projections of tax revenues have differed materially from what the Commonwealth has been able to achieve. Revenues for the first ten months of fiscal year 2015 are $250.6 million below projected revenues for the period and the most recent estimates indicate lower revenues for the year of $651 million (before considering new revenue measures recently implemented or proposed to be implemented, which are expected to result in a deficit of $191 million). As a result, there is no assurance that the Commonwealth will be able to achieve its tax revenue projections and, to the extent the Commonwealth fails to achieve such projections, the Commonwealth may need to implement further expenditure reductions or revenue enhancing measures in order to meet its obligations as they come due.

In order to achieve a balanced budget for fiscal year 2016, the Commonwealth will also have to address certain cost escalators during fiscal year 2016, currently estimated by OMB to total approximately $1.068 billion. See "FISCAL CONDITION – Fiscal Year 2016 Budget" for a description of these cost escalators.

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

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

As of March 31, 2015, the Commonwealth had outstanding a total of $22.604 billion aggregate principal amount of bonds and notes issued or guaranteed by the Commonwealth or payable from General Fund appropriations, equivalent to approximately 33% of the Commonwealth's gross national product for fiscal year 2014 ($69.202 billion - preliminary). Debt service for fiscal year 2016 on these bonds and notes payable from the General Fund ($1.970 billion) represents approximately 21% of the General Fund budget for fiscal year 2015 ($9.565 billion). Maximum annual debt service on these bonds and notes ($2.350 billion in fiscal year 2028) represents approximately 25% of the General Fund budget for fiscal year 2015.

The total outstanding public sector debt of the Commonwealth, its instrumentalities, and municipalities was $72.204 billion as of March 31, 2015, equivalent to approximately 104% of the Commonwealth's gross national product for fiscal year 2014. See "DEBT – Public Sector Debt" below. The foregoing calculations exclude the $1.2 billion in TRANs due between April and July of 2015 (of which $900 million are guaranteed by the Commonwealth) and their corresponding debt service.

In addition to the bonds and notes issued or guaranteed by the Commonwealth or payable from General Fund appropriations, other government instrumentalities of the Commonwealth have significant debt service obligations that are payable in whole or in part from taxes. As of March 31, 2015, COFINA had $15.224 billion principal amount of bonds and notes payable from sales and use tax revenues. PRHTA had $6.530 billion principal amount of bonds and notes payable in part from petroleum taxes and other taxes. And the Employees Retirement System had $2.948 billion principal amount of bonds payable in part from contributions to the System made by the Commonwealth (which are in turn funded by taxes collected by the Commonwealth). See "DEBT – Debt Service Requirement for Bonds Issued or Guaranteed by the Commonwealth and Publicly-Issued Commonwealth Appropriation Bonds" and "DEBT – Debt of the Public Corporations."

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

***The Commonwealth's ability to raise additional revenue through taxation may be limited by economic factors.***

The capacity of a state to raise tax revenue is typically measured by the levels and rates of change in economic activity and the income of its citizens and businesses. The amount of tax paid by individuals and companies relative to total income ("tax burden") is one approximation of capacity to raise additional revenue through taxation. The composition of taxes is also relevant. For example, certain types of activity may be highly sensitive to taxation or incremental costs generally. Imposing or increasing taxes on such activity could significantly curb it, which would undermine both potential tax revenue and economic growth.

In evaluating the capacity of the Commonwealth to raise additional revenue through taxation, one should be mindful of its available base, in the aggregate and in specific categories of activity. On an aggregate basis, economic output and income can be approximated by gross domestic product ("GDP") and gross national product ("GNP"). GDP measures expenditures and income earned within a state, while GNP includes income from foreign sources but excludes income paid to foreign entities. For states with significant net direct investment held by foreigners, GNP can be materially lower than GDP. Taxing the difference between the two aggregate measures can be challenging given the desire to retain that direct investment, which generates employment and both direct and indirect economic activity.

The difference between these two measures of economic expenditures and income is acute in Puerto Rico. According to preliminary estimates from the Puerto Rico Planning Board, in fiscal year 2013 nominal GNP was 31 percent lower than nominal GDP. This arises from U.S. mainland corporations' accounting for a substantial share of production taking place in Puerto Rico through activities of their subsidiaries, in particular in the manufacturing sector.

The Commonwealth has been taxing a portion of the income earned by these corporations from activity in Puerto Rico, but proceeds from such taxes may not persist. Act 154-2010, as amended ("Act 154"), imposes a temporary excise tax to capture the repatriation of profits and dividends to parent firms on the U.S. mainland. The negative impact of that tax on those firms has, to date, been neutralized in part by creditability provided by U.S. Federal authorities. Future Federal credibility is not guaranteed. The persistence and rate of excise tax imposed pursuant to Act 154 will likely affect the decisions of the firms' subsidiaries to continue operations in Puerto Rico.

As a result, using GDP to calculate the current tax burden in Puerto Rico may overstate the capacity of the Commonwealth to raise additional revenue through taxation. And international comparisons with the tax burden in Puerto Rico based on GDP may be misleading or require adjustments.

At the same time, although to a lesser extent, GNP may overstate the available tax base. Residents of Puerto Rico benefit from large transfers from the US Federal government. According to the Puerto Rico Planning Board, in fiscal year 2013 Federal transfer payments accounted for 24 percent of personal income. Under current federal law, some of these transfer payments earmarked for social welfare programs may not be taxed by the Commonwealth.

One should also account for differences in behavioral responses among categories that are taxable. The impact of changes in the rates of taxation on consumption and employment from taxes on goods and services, on the one hand, and income, on the other hand, could vary materially, with respect to both incremental tax receipts and broad economic activity.

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

The economic recession that has affected the Commonwealth since fiscal year 2007 and the income tax reduction program adopted in fiscal year 2011 has negatively affected Commonwealth income tax revenues. The special temporary excise tax imposed by Act 154, has become one of the Commonwealth's principal sources of tax revenues. For fiscal years 2012, 2013 and 2014, the revenues produced by Act 154 represented approximately 21.6%, 19.7%, and 20.3%, respectively, of the Commonwealth's General Fund revenues. During fiscal year 2014, the special temporary excise tax was paid by 35 companies of which eight companies accounted for approximately 85% of collections. To the extent that any of these taxpayers reduces its operations in Puerto Rico or moves its operations to a different jurisdiction, the Commonwealth's tax base would be reduced and its revenues would be adversely affected. Factors that can cause a reduction in the level of Act 154 revenues include a reduction in the level of local economic activity of the corporations that pay the Act 154 taxes, which might occur as a result of general economic conditions or factors affecting individual companies, any difficulties in the transition, after December 31, 2017, from the Act 154 temporary excise tax to the modified source of income rule under Act 154, and any action by the U.S. Treasury Department to reduce or eliminate the federal income tax credit available with respect to the Act 154 temporary excise tax. For a discussion of Act 154, see "COMMONWEATH TAXES, OTHER REVENUES AND EXPENDITURES – Special Excise Tax (Act 154)" in the Base Commonwealth Report.

It is not likely that the effectiveness of Act 154 will extend beyond December 31, 2017. Thus, absent action by the U.S. Internal Revenue Service, the special temporary excise tax will no longer apply and will be replaced by the "modified source of income rule" under Act 154. There is no assurance that the level of tax collection under the "modified source of income rule" will be sufficient to replace the tax revenues currently received by the Commonwealth pursuant to the special temporary excise tax under Act 154. To the extent the Commonwealth is unable to replace these tax revenues with revenues under the "modified source of income rule," it may not have sufficient revenues to fully fund its operations. This may require the Commonwealth to adopt some of the emergency measures affecting creditor's rights described above in "*The Commonwealth may need to implement administrative and emergency measures in fiscal year 2016 and thereafter, which could include a moratorium on the payment of debt service or debt adjustment.*"

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

The Commonwealth, through PRHIA provides health insurance coverage to approximately 1.6 million qualifying (generally low-income) residents of Puerto Rico. The cost of this health insurance program is very significant, totaling $2.5 billion for the year ended June 30, 2014. A substantial portion of this cost is currently paid by the federal government and funded principally by non-recurring funding provided pursuant to the federal Patient Protection and Affordable Care Act (the "Affordable Care Act" or "ACA"), as well as recurring Medicaid and Children's Health Insurance Program ("CHIP") funds, which in the case of the Commonwealth are capped at a level lower than that applicable to the states (which are not capped).

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

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

The fiscal stability of the Commonwealth's health insurance program is one of the most significant budgetary challenges facing the Commonwealth, especially if the availability of ACA funds is not renewed or Medicaid funds are not significantly increased. In light of the current disparity in the treatment that the Commonwealth receives compared with the states with respect to the cap imposed on Medicaid matching funds, the Commonwealth is intensifying its efforts to have ACA funding renewed by Congress. The Resident Commissioner is also involved in these efforts and recently members of the private and public sector formed the Puerto Rico Healthcare Crisis Coalition. However, it is not possible to predict the likelihood that such efforts will succeed, and the Commonwealth will continue evaluating the fiscal structure of the program taking into consideration the current federal funding depletion estimates. To the extent these efforts are unsuccessful, it is unlikely that the Commonwealth would be able to assume a significantly higher portion of the cost of the health insurance program. If the Commonwealth is unable to reduce these costs, it may be required to adopt some of the emergency measures described above in "*The Commonwealth may need to implement administrative and emergency measures in fiscal year 2016 and thereafter, which could include a moratorium on the payment of debt service or debt adjustment.*"

***If certain government instrumentalities that provide essential services require support from the Commonwealth to continue to provide such essential services, the Commonwealth may need to prioritize the funding of such services over financial or other obligations.***

Several public corporations and instrumentalities have traditionally relied on subsidies or other transfers from the General Fund to fund a portion of their operations. The current administration has announced a policy of requiring its instrumentalities to achieve self-sufficiency in the near future. Certain of these instrumentalities offer basic and essential services to the population of Puerto Rico. To the extent that any of these instrumentalities is unable to continue to provide such essential services, the Commonwealth may be required to divert available Commonwealth resources to ensure that such services continue to be provided. To the extent Commonwealth resources are diverted to such essential services, the Commonwealth may not have sufficient revenues to honor all of its obligations as they come due.

In particular, the Puerto Rico Health Insurance Administration ("PRHIA"), the Puerto Rico Medical Services Administration ("PRMSA"), the Puerto Rico Municipal Islands Maritime Transport Authority ("MIMTA"), the Puerto Rico Metropolitan Bus Authority ("PRMBA") and the University of Puerto Rico ("UPR") provide essential services to the residents of Puerto Rico and rely heavily on General Fund appropriations to fund their operations. Others, like the Public Buildings Authority ("PBA"), provide essential services to the Commonwealth's government. For example, the General Fund Budget for fiscal year 2015 included approximately $892 million in appropriations to PRHIA, $27 million to PRMSA, $881 million to UPR, $20 million to MIMTA and $9 million to PRMBA. In addition, the General Fund Budget for fiscal year 2015 includes rent payments of $366 million payable to PBA. Notwithstanding the Commonwealth's support, certain of these public corporations suffer from significant annual operating losses and carry material amounts of accounts payable. Some of the services provided by these public corporations are essential to maintain health, public safety and welfare, which may lead the Commonwealth to prioritize the funding of such services over financial or other obligations.

***The assets of the Commonwealth's retirement systems may be completely depleted within the next three to six fiscal years unless the Commonwealth makes significant additional contributions to the retirement systems, and the Commonwealth may need to prioritize the funding of such retirement systems over financial or other obligations.***

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

As described under "RETIREMENT SYSTEMS AND OTHER POST-EMPLOYMENT BENEFITS" in the Base Commonwealth Report, the Puerto Rico Supreme Court declared invalid certain aspects of the legislation relating to the reform of the Teachers Retirement System and limited the effect of the reform of the Judiciary Retirement System. Failure to amend the legislation in order to compensate for the effect of the provisions declared invalid will lead to the depletion of the assets of these Retirement Systems. Furthermore, in the case of the Employees Retirement System, the Commonwealth has been unable to make all the additional annual employer contributions required by the reform legislation, which could also lead to the depletion of the assets of the Employees Retirement System. If this happens, the Retirement Systems would be operating solely on a "pay-as-you-go" basis, which means that they would be unable to pay benefits that exceed the actual employer and employee contributions received by the Retirement Systems (net of administrative and other expenses), unless the Commonwealth and the other participating employers provide the funding required to meet the pay-as-you-go retirement benefits.

As discussed in the Base Commonwealth Report, the pension reform and other legislation enacted in 2011 and 2013 increased the annual amount that the Commonwealth must provide to the Retirement Systems in order to allow them to meet their annual pension obligations. In addition to the gradual increase in employer contribution rates that was legislated in 2011 and certain other supplemental contributions established by the reform laws, Act 32-2013 provides for the payment of an annual additional uniform contribution from the employers at levels to be determined by the actuaries. In the case of the Employees Retirement System, the annual additional uniform contribution required to be made by employers for fiscal years 2014 and 2015 was set at $120 million, of which approximately $78 million was allocable to the central government and the balance was allocable to the municipalities and participating public corporations. The Commonwealth, some municipalities and participating public corporations, however, were not able to make the required additional uniform contribution in full for fiscal year 2014 and will also be unable to make the required additional uniform contribution in full for fiscal year 2015. With respect to the required additional uniform contribution for fiscal years 2014 and 2015, the Employees Retirement System has received approximately $33 million and $5.8 million, respectively, from some of the public corporations and municipalities but has not received the corresponding contribution from the Commonwealth and some public corporations that depend on the Commonwealth for the funding of their operations.

Act 32-2013 also provides that, after fiscal year 2015, the annual additional uniform contribution shall be calculated such that the gross assets of the Employees Retirement System are never less than $1 billion. Given the extraordinary retirement pattern of central government employees during fiscal year 2014 resulting from the enactment of the pension reform, and the correspondingly lower payroll contribution base, the required additional uniform contribution required to be made by the central government has been calculated at $216 million for fiscal year 2016. These funding requirements will place an additional demand on the Commonwealth's need for fiscal adjustment. If the Commonwealth were unable to make these additional contributions to the Employees Retirement System, its gross assets would be expected to be depleted during fiscal year 2021. However, given that the Employees Retirement System's assets include a significant amount of loans to members, which may not be readily sellable, the System may face liquidity problems sooner that the projected full depletion date of its assets.

In the case of the Teachers Retirement System, the reforms enacted by Act 160-2013 were largely struck down by the Supreme Court. Although most of the expected savings of the reform were based on the changes that affected current participants, the reform measures that were upheld mostly affect benefits to participants that enter the System on or after August 1, 2014. Act 160-2013 requires two classes of additional annual contributions to the Teachers Retirement System, namely (i) a $30 million contribution for each of fiscal years 2017 and 2018 and $60 million thereafter until fiscal year 2042, and (ii) a contribution, commencing on fiscal year 2019 and continuing until fiscal year 2042, determined actuarially as the amount calculated such that the gross assets of the System are never less than $300 million, which is currently estimated at approximately $450 million. If the Commonwealth were unable to make these additional contributions to the Teachers Retirement System, its assets would be expected to be depleted during fiscal year 2019. As described with respect to the Employees Retirement System, the Teachers Retirement System also holds a significant amount of loans to members and, as a result, the System may face liquidity problems sooner than the projected full depletion date of its assets.

Similarly, in the case of the Judiciary Retirement System, the reforms enacted by Act 162-2013 were limited by the Supreme Court. Unless certain annual additional contributions are made to the Judiciary Retirement System, which pursuant to Act 162-2013 are determined actuarially as the amount calculated such that the gross assets of the System are never less than $20 million (currently estimated at approximately $12 million per year), its assets are projected to be completely depleted during fiscal year 2018.

In addition, to the extent the assumptions used to estimate the effect of these reforms on the General Fund are not realized, the Commonwealth may be adversely affected as it may have to use additional resources to meet these obligations. In particular, the fiscal adjustment that may be required by the Commonwealth as a result of its fiscal condition may result in a lower level of payroll and an increase in the number of retirees, any of which in turn, absent other compensating factors, would result in the need to further increase the annual additional uniform contribution or else the depletion date of the Retirement Systems' assets would occur earlier. Given the importance of pension benefits to retirees, the Commonwealth may need to prioritize the funding of its Retirement Systems over its financial or other obligations. See "Update on the Condition of the Retirement Systems" in this Quarterly Report and "RETIREMENT SYSTEMS AND OTHER POST-EMPLOYMENT BENEFITS" in the Base Commonwealth Report.

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

The Constitution of Puerto Rico also provides that the Commonwealth shall not guarantee any obligation evidenced by bonds or notes if the principal and interest on all such debt payable in any fiscal year, together with any amount paid by the Commonwealth in the prior fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual internal revenues of the Commonwealth in the two preceding fiscal years. (Such percentage is currently 13.7%.) Therefore, although bonds and notes guaranteed by the Commonwealth are considered public debt and enjoy the same priority of payment protection that is afforded by the Constitution of Puerto Rico to bonds and notes issued by the Commonwealth for which its good faith, credit and taxing power has been pledged, debt service payable on such guaranteed obligations is not taken into consideration for purposes of the Constitutional debt limit unless the Commonwealth is actually paying such debt service pursuant to its guarantee. Accordingly, the Commonwealth may continue to guarantee bonds and notes issued by its instrumentalities as long as the 15% limitation is not exceeded. As of March 31, 2015, $5.5 billion of such guaranteed obligations were outstanding (excluding $267 million of GDB Bonds maturing in December 2015, and $110 million of GDB Senior Guaranteed Notes, Series 2013B, maturing between July 1, 2018 and July 1, 2020). In addition, as of May 1, 2015, GDB had outstanding $500 million of notes guaranteed by the Commonwealth and maturing on or prior to June 30, 2015, the proceeds of which were used to purchase fiscal year 2015 TRANs.

The Commonwealth has statutory authority to provide additional guarantees until the 15% limitation is reached. As of December 31, 2014, the Commonwealth had authorization to guarantee approximately $4.6 billion of PBA obligations, of which approximately $4.1 billion aggregate principal amount of such obligations is currently outstanding, and $2.0 billion of obligations of GDB and certain instrumentalities, of which approximately $377 million (excluding the $500 million in notes mentioned above) is currently outstanding. The Commonwealth also recently enacted legislation that authorizes the issuance of up to $2.95 billion of PRIFA bonds and notes guaranteed by the Commonwealth, the proceeds of which would be used to refund certain debt of the PRHTA owed to GDB and other lenders. On March 17, 2015, PRIFA issued approximately $246 million of bond anticipation notes guaranteed by the Commonwealth. PRIFA plans to issue long-term bonds guaranteed by the Commonwealth prior to June 30, 2015, subject to market conditions, the proceeds of which will be used to repay these bond anticipation notes and all or a portion of PRHTA's debt with GDB.

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

On several occasions the Commonwealth has failed to comply with its continuing disclosure obligations on a timely basis. For example, the Commonwealth has failed to file the Commonwealth's Annual Financial Report before its 305-day deadline in ten of the past thirteen years, including the three most recent fiscal years (2012, 2013 and 2014). Although the Commonwealth has implemented certain procedures to ensure timely compliance with its continuing disclosure obligations, there is no assurance that these procedures will be effective in ensuring timely compliance. Moreover, the Commonwealth's failure to comply with its continuing disclosure obligations on a timely basis could limit its access to the capital markets, because underwriters for Commonwealth bonds must be able to reasonably determine that the Commonwealth will comply with its continuing disclosure obligations on a timely basis before underwriting any future offerings of Commonwealth debt.

## FISCAL CONDITION

### Preliminary General Fund Revenues for the First Ten Months of Fiscal Year 2015 and Expenditures for the First Nine Months of Fiscal Year 2015; Projected Budget Deficit for Fiscal Year 2015

***Revenues.*** Preliminary General Fund revenues for the first ten months of fiscal year 2015 (July of 2014 through April of 2015) were approximately $7.335billion, an increase of $61.6 million, or 0.8%, when compared to the same period of the prior fiscal year, but $250.6 million less than estimated revenues for the period. Preliminary collections for the special temporary excise tax under Act 154 were $1.553 billion, an increase of $28.8 million from the same period of the prior fiscal year, and $9.4 million more than the projected revenues for this period. Preliminary collections of individual income taxes were $1.976 billion, an increase of $288.3 million over the same period of the prior fiscal year, but $44.4 million below projections. Preliminary collections of corporate income taxes were $1.401 billion, $119.2 million less than the same period of the prior fiscal year, and $149.1 million below projections, mainly as a result of the repeal of the gross receipts tax in December 2014. As of April 30, 2015, the non-recurring revenue was estimated at approximately $625 million and the Treasury Department is estimating additional non-recurring revenues for fiscal year 2015 of approximately $185 million.

***Expenditures.*** The General Fund budget for fiscal year 2015 amounts to $9.565 billion. This amounts consists $4.915 billion in Joint Resolution General Fund ("JRGF") and $4.650 billion pertaining to Special Appropriations ("SA").

For the first nine months of fiscal year 2015, OMB estimates that General Fund expenses were approximately $6.4 billion. JRGF expenses are estimated at $3.3 billion (68% of the yearly JRGF budgeted amount), while SA expenses are estimated at $3.1 billion (66% of the SA budgeted amount). In preparing such estimates, OMB takes into consideration transactions that have been recorded and accounted for in the central government accounting system. These estimates are preliminary and are subject to further adjustments.

The $9.565 billion budget for fiscal year 2015 contemplates $1.138 billion for debt payments, of which $743 million are assigned for payments of General Obligations debt service. The remaining $8.427 billion are assigned for Commonwealth operations, including payroll.

The General Fund payroll budget consists of approximately $3.4 billion. The Central Government's employee workforce chargeable to the General Fund, which is accounted for in the Treasury Department's payroll system, amounts to 89,576 employees (headcount), of which 70% consists primarily of teachers (37,000), police officers (15,000), correction officers (7,800), firefighters (1,700) and nurses (1,330).

As a measure of expenditure control, OMB has identified and taken a $125 million budget reserve during the current fiscal year, for an adjusted fiscal year 2015 budget of $9.440 billion. This budget reserve includes, but is not limited to, the elimination of certain contingency accounts, a reduction in program appropriations that are not considered priority items, and a reduction in the operating budget of agencies chargeable to the General Fund. These appropriations were identified for budgetary adjustment in conformity with the schedule of priorities set forth in OMB's organic act, and in consideration of the projected shortfall in General Fund revenue.

***Projected Budget Deficit.*** As discussed above, revenues for the ten months of fiscal year 2015 are $250.6 million below the originally projected revenues for that period. The Treasury Department expects that the trend of lower actual versus projected revenues will continue for the remaining months of the fiscal year. The Treasury Department's most recent revenue estimates indicate that total revenues for fiscal year 2015 may be approximately $651 million less than what was originally estimated absent the implementation of additional revenue measures. The main drivers for the reduction in fiscal year 2015 estimated revenues are the following:

- A reduction on corporate income taxes of approximately $230 million, of which $200 million are related to the mid-fiscal year repeal of the gross receipts tax ("Patente Nacional") for taxable year 2015, which was originally supposed to become effective at the same time as the enactment of the proposed Tax Reform Bill in order to offset the loss of revenues from the repeal of the "Patente Nacional" with the new revenues arising from the proposed Tax Reform Bill.

- A reduction in sales and use taxes in the point of entry of approximately $120 million, mainly attributable to lower than expected economic activity and delays in the implementation of the sales and use tax at the point of entry.

- A reduction of approximately $90 million in motor vehicle excise taxes as a result of the decrease in the sale of motor vehicles in Puerto Rico due to lower than expected economic activity, and the rate of such taxes pursuant to Act 186-2014. As of October 31, 2014, prior to the enactment of Act 186-2014, revenues for motor vehicle excise taxes had decreased by approximately $30 million.

- A reduction of approximately $60 million on individual income taxes, mainly as a result of lower than expected economic activity.

- A reduction of approximately $46 million in rum-cover over tax revenues resulting in part from the non-extension by the U.S. Congress for calendar year 2015 of the increase from $10.50 to $13.25 per proof gallon, in the federal excise tax rate on rum produced in Puerto Rico and exported into the U.S., which the federal government transfers (or "covers over") annually to the Commonwealth. The original estimates assumed that the cover over excise tax rate of $13.25 per proof gallon would have been extended for calendar year 2015.

- An aggregate reduction of approximately $105 million in other miscellaneous taxes, primarily due to the reduction in economic activity and other factors.

The lower than expected revenues thus far are the result, in part, of a difficult economic environment, and of changes that the original revenue measures suffered during the legislative process, which were partially offset by higher than expected collections resulting from other mostly non-recurring measures, such as the enactment of a prepayment window for individual retirement accounts (IRAs), retirement plans and annuities at a special rate.

To close the currently estimated revenue gap of approximately $651 million, the Government has implemented or is in the process of implementing the following measures:

- Enactment of Act 44-2015, which provides for a reduced tax on prepayments of individual retirement accounts, a special temporary tax for corporate dividends and a tax amnesty. Treasury currently estimates that these measures will generate approximately $160 million in revenues. As of April 30, 2015, approximately $150 million of the estimated $160 million had been collected. The remaining $10 million are expected to be collected between the months of May and June of fiscal year 2015.

- The execution of additional tax closing agreements in excess of those originally budgeted by the Treasury Department are expected to generate approximately $75 million in additional revenue in June 2015.

- The enactment of H.R. Bill 221, introduced in April 14, 2015, which authorizes a dividend of $100 million from the State Insurance Fund. This bill has already been approved by the House of Representatives, and is currently pending approval of the Senate.

- $125 million in cuts to budgetary appropriations, which have already been implemented by OMB through the elimination of certain contingency accounts, reductions in non-priority program appropriations, and a decrease in the operating budget of various agencies funded by the General Fund.

Assuming the successful implementation of the above-referenced revenue and expense measures, the Commonwealth estimates that it would end fiscal year 2015 with a budget deficit of approximately $191 million (not including $344 million in capitalized interest on general obligation bonds due during the current fiscal year and financed through prior general obligation bond offerings). There is no assurance, however, that the above measures, even if successfully implemented, will generate the increases in revenues or reductions in expenditures that are currently projected.

In addition, the above budget deficit estimate also assumes that the Commonwealth will not incur expenditures above those budgeted for fiscal year 2015, as adjusted for the $125 million in identified cuts in budgetary appropriations. Due to the deficiency of existing accounting systems and other tools to track the accrual of central government expenses on an ongoing basis, it is possible that material expenses may have been incurred but not yet identified by OMB. However, OMB is monitoring budget execution and the information received thus far reflects that expenditures are aligned with the annual budget.

The Commonwealth is currently evaluating other measures that may be necessary to cover any remaining budget deficit. Such measures may include reductions in budgeted expenditures pursuant to Article 4 of the OMB Organic Law similar to reductions made by Executive Order 29-2014.

**Preliminary General Fund Budgetary Revenues and Expenditures for Fiscal Year 2014**

***Revenues.*** Preliminary General Fund revenues for fiscal year 2014 (which are still subject to audit and other year-end adjustments) were $9.037 billion, and include: (i) total budgetary operating revenues of the General Fund of $8.803 billion, (ii) revenues from the electronic and traditional lotteries of $154 million that are available to the General Fund, and (iii) $80 million in excess funds transferred from COFINA to the General Fund after payment of COFINA debt service. This represented an increase of $475 million over budgetary revenues for fiscal year 2013 ($8.562 billion), but was $488 million lower than the revised projected revenues for this period ($9.525 billion). The increase in budgetary revenues during this period when compared to fiscal year 2013 is primarily due to legislative measures adopted since January 2013.

Corporate income tax collections for fiscal year 2014 were $1.914 billion, an increase of $628 million, or 48.8%, from the same period of the prior fiscal year. These revenues are $599 million, or 23.8%, less than the revised projected revenues for this period. Individual income tax collections for fiscal year 2014 were $1.979 billion, a decrease of $75 million, or 3.7%, from the same period of the prior fiscal year, and $24.6 million, or 1.22%, less than the revised projected revenues of this category for this period. Collections from withholdings from non-residents were $900 million, a decrease of $83 million, or 8.4%, from prior fiscal year, but $80 million, or 9.8%, more than the revised projected revenues of this category for this period.

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

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

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

***Expenditures***. The original fiscal year 2014 budgeted expenditures totaled $9.770 billion, excluding $575 million in general obligation debt service, a portion of which was refunded with the proceeds of the Commonwealth's General Obligation Bonds of 2014, Series A and the remainder funded with interim lines of credit by GDB. The budget contemplated $245 million in new deficit financing to be funded initially by GDB which, when added to the $575 million general obligation debt refunding, resulted in a total projected budget deficit of $820 million. The budget was subsequently amended to total $9.245 billion in expenditures (excluding the $575 million in general obligations debt service refunding) as follows:

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

(ii) In June of 2014, the Governor signed Executive Order 29-2014, which ordered cuts in appropriations totaling $355 million: a reduction of $24 million in the appropriation for rent payments to the PBA, a reduction of $84 million in the appropriation to the Employees Retirement System required by the pension reform, and a reduction of $247 million in the appropriation for the payment of loans to GDB, for an adjusted budget of $9.245 billion. (These reductions adversely affected the liquidity of these entities.)

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

These appropriations were selected for adjustment in conformity with the schedule of priorities set forth in Act 147, and in consideration of the fact that the magnitude and timing of the April 2014 revenue shortfall giving rise to the cash gap was such that countervailing cuts in operating expense appropriations were impractical without a drastic and sudden slowdown in government operations, particularly in light of the prior $170 million reduction in the budget.

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

Although still subject to audit and other year-end adjustments, budgetary expenditures for fiscal year 2014 are expected to be higher than the adjusted budget of $9.245 billion by approximately $85 million, for a total actual expense of $9.330 billion, excluding $575 million in general obligation debt service. This amount does not consider the estimated deficits of public corporations that receive material operating or program subsidies from the General Fund budget, such as the MIMTA, PRHIA, PBA, PRMBA, UPR and PRMSA.

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

The preliminary General Fund Budget deficit for fiscal year 2014 is $869 million, calculated by subtracting preliminary General Fund budgetary revenues for fiscal year 2014 of $9.037 billion from preliminary General Fund budgetary expenditures for fiscal year 2014 of $9.905 billion ($9.330 billion base expenditures plus $575 million in refunded or refinanced general obligation debt service).

**Fiscal Year 2016 Budget**

The Commonwealth is in the process of preparing the budget for fiscal year 2016. It will have to start with a revenue base below the one used for the fiscal year 2015 budget due to the above-referenced revenue shortfall and the exclusion of various non-recurring items from fiscal year 2015. As of April 30, 2015, the non-recurring revenue was estimated by the Treasury Department at approximately $625 million and the Treasury Department is estimating additional non-recurring revenues for fiscal year 2015 of approximately $185 million.

In addition to a lower revenue base, the Commonwealth will have to address certain cost escalators in fiscal year 2016, currently estimated by OMB to total approximately $1.068 billion. These cost escalators include: (i) $553.0 million in additional debt service requirements, consisting of $268.5 million in increased debt service for General Obligation bonds, $53.1 million in increased debt service for new TRANs (based on actual TRANs costs for fiscal year 2015), $55.5 million in increased debt service for Commonwealth appropriation bonds issued by PFC, $156.6 million in increased debt service for GDB loans payable from legislative appropriations, and $19.3 million in legislative appropriation with respect to the Tourism Development Fund, (ii) $257 million in additional contributions to the government pension plans, consisting of the portion of the Additional Uniform Contribution for the Employees Retirement System, as determined by the actuaries, corresponding to the Commonwealth's central government and the increase in Commonwealth contributions due to the 1% increase in the statutory employer contribution rates, (iii) $130 million in higher operating subsidy requirements for the health insurance plan; (iv) $40 million in incremental rent and utility payments; (v) $30 million for PRITA; (vi) $30 million for planned improvements to the Treasury Department's tax collection systems; and (vii) $28 million for the Comprehensive Cancer Center. Expense reduction measures of approximately $250 million have already been identified for the fiscal year 2016 budget. These measures include school consolidations, a reorganization of the collective transportation system, a reduction in special appropriations and other measures.

As discussed above, the Treasury Department had projected that the Tax Reform Bill would have generated approximately $1.2 billion in additional recurring revenues to the General Fund by broadening the tax base and increasing consumption tax rates. Since the Tax Reform Bill was not approved, the Executive Branch is considering significant expense reduction measures in addition to those already identified and is evaluating alternative revenues measures in order to submit a balanced budget for fiscal year 2016.

## GDB Funding and Liquidity

One of GDB's objectives is to maintain sufficient liquidity to fund its existing asset base and to meet its financial obligations and provide public sector financing in accordance with its mission. GDB's cash and liquid assets are referred to herein as its "liquidity resources."

GDB's primary sources of funding consist of: (i) public sector deposits, which are GDB's lowest cost source of funding, (ii) senior notes issued by GDB in the bond market with maturities ranging from calendar year 2015 through 2026 and (iii) repurchase agreements. The following table sets forth a breakdown of GDB's (excluding its subsidiaries) total funding by source as of September 30, 2014, December 31, 2014 and March 31, 2015 (figures in thousands). These numbers are preliminary and unaudited.

| **Funding Sources** | **9/30/2014** | **%** | **12/31/2014** | **%** | **3/31/15** | **%** |
|---|---|---|---|---|---|---|
| Public Deposits | $4,379,545 | 45.8% | $4,139,215 | 39.0% | $4,576,260 | 43.6% |
| Private Deposits | 42,855 | 0.5% | 37,865 | 0.4% | 32,865 | 0.3% |
| Bonds and Notes | 4,633,338 | 48.4% | 5,464,707 | 51.5% | 5,137,257 | 49.0% |
| Repurchase Agreements | 512,353 | 5.4% | 961,348 | 9.1% | 747,951 | 7.1% |
| Total | $9,568,091 | 100% | $10,603,135 | 100% | 10,494,333 | 100% |

As of March 31, 2015, GDB's average cost of funding was 3.1% and the average life of its liabilities was 2.1 years. The increase in bonds and notes outstanding since September 30, 2014 is due to the issuance of $900 million in notes used to fund the Commonwealth's TRANs financing for fiscal year 2015. The entire principal amount of these short-term notes is due during the fourth quarter of fiscal year 2015. In addition, approximately $876 million in outstanding bonds mature in fiscal year 2016 (with staggered maturities in August and December of 2015 and May of 2016).

As of March 31, 2015, GDB's liquidity resources included: (i) approximately $151.7 million of deposits made by PREPA for its Reserve Account, which are invested in GDB time deposits, (ii) $189.8 million of deposits made by PREPA for its Construction Fund, which are invested in GDB time deposits, (iii) $263 million of deposits made by the Puerto Rico Public Housing Administration ("PRPHA"), which are invested in GDB time deposits, and (iv) $60.2 million of funds classified as "restricted assets," mostly consisting of proceeds from the issuance of tax-exempt GDB notes that are required to be used for certain qualifying purposes and that GDB expects to use during fiscal year 2016 to fund qualified disbursements under lines of credit extended by GDB to the Commonwealth and certain public corporations. During the remainder of fiscal year 2015, GDB also expects PREPA to use approximately $100 million on deposit from the Construction Fund and approximately $100 million of the funds on deposit in the Debt Service Reserve Fund currently held at GDB. Since April 30, 2014, GDB has been depositing the monthly sinking fund payments for the Commonwealth General Obligation bonds with a third party financial institution, and is no longer holding those funds on deposit. GDB is also projecting a gradual withdrawal of the $263 in deposits from the PRPHA to occur between April 1 and December 31, 2015.

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

***Liquidity Resources***. As of March 31, 2015, GDB's cash, bank deposits and investment portfolio at fair market value was $1.9 billion, or 15%, of GDB's assets (excluding its subsidiaries). The following table shows GDB's liquidity resources by source, including the investment securities portfolio, which constitutes an important source of liquidity for GDB because it may be realized through either sales of securities or repurchase agreements:

| **Liquidity Resources (in millions)** | **6/30/2014** | **9/30/2014** | **12/31/2014** | **3/31/2015** |
|---|---|---|---|---|
| Cash and Bank Deposits | $719 | $232 | $333 | $348 |
| Federal Funds Sold and Money Market Instruments (excluding $39 million reverse repurchase agreement with GDB subsidiary) | 1,052 | 340 | 191 | 210 |
| Investment Securities | | | | |
| U.S. Treasury and Agencies | 1,191 | 1,356 | 1,363 | 1,296 |
| Government-Sponsored MBS and CMOs | 210 | 2 | 0 | 0 |
| Other Securities | 39 | 1 | 226 | 60 |
| Sub-Total | 1,440 | 1,359 | 1,589 | 1,356 |
| Total | $3,211 | $1,931 | $2,113 | $1,914 |
| Securities pledged | (72) | (533) | (1,023) | (796) |
| Net Liquidity | $3,139 (1) | $1,398 (2) | $1,090 | $1,118 |

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

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

GDB's investment portfolio consists mostly of investment securities classified among the three highest rating categories. As of March 31, 2015, the expected average life of the investment securities portfolio was 2.0 years and approximately $605 million, or 47%, matures in less than one year.

The primary factors driving the net reduction in cash and unencumbered investment securities held by GDB as of March 31, 2015 compared to September 30, 2014 were (i) loan disbursements to agencies, corporations and municipalities, (ii) debt service payments to GDB note holders, and (iii) ordinary course fluctuations in GDB's deposit base, including the Secretary of the Treasury's account at GDB.

As of March 31, 2015, of the approximately $1.9 billion investment securities portfolio, approximately $776 million was pledged to secure or repay borrowings of GDB, consisting of securities sold under agreements to repurchase and $20 million was pledged for other uses. Therefore, as of March 31, 2015, GDB liquidity resources, net of pledged securities, amounted to approximately $1.1 billion, approximately $20 million higher than as of December 31, 2014 but approximately $180 million lower than September 30, 2014.

Although PRPHA has deposited federal funds received from HUD at GDB since at least 2004, by letters dated March 30, 2015, the U.S Department of Housing and Urban Development ("HUD") informed the PRPHA that its deposits with the GDB require the execution of General Depository Agreements by such agency with the GDB and that failure to execute such General Depository Agreements is a violation of the Consolidated Annual Contributions Contract of such agencies with HUD. HUD's form of General Depository Agreement requires that the counterparty depository institution be insured by the Federal Depository Insurance Corporation ("FDIC"), which GDB is not. As a result, PRPHA agreed with HUD to deposit all future federal grants and other monies with FDIC-insured institutions. GDB is therefore projecting a gradual withdrawal of $263 million of PRPHA funds deposited at GDB between April 1 and December 31, 2015. GDB is expecting to fund this withdrawal out of its current liquidity resources.

In its "Special Liquidity Update", dated October 17, 2014, GDB provided a liquidity projection for the remainder of fiscal year 2015 and the first quarter of fiscal year 2016 that projected that, in the absence of a capital markets transaction, it would not have sufficient liquidity to meet its legal reserve requirement by the first quarter of fiscal 2016. Since the publication of such Special Liquidity Update, various critical assumptions underlying GDB's liquidity projections have been revised, including future deposit net flows, loan origination volumes and loan portfolio repayments. However, internal GDB liquidity projections as of the date of this Quarterly Report, suggest that, assuming no capital market transaction is completed and that the Commonwealth repays its appropriation lines of credit as budgeted, GDB would still be unable to comply with its legal reserve requirement by early in the first quarter of fiscal year 2016. This liquidity projection does not take into consideration the implementation of other potential liquidity enhancing or conservation measures, requiring the transfer to GDB of public deposits at private financial institutions, implementing liability management transactions with respect to GDB's outstanding notes and bonds and/or imposing other restrictions on liquidity outflows.

**Historical General Fund Budget Deficits**

One of the most significant challenges that the Commonwealth has faced for many years is an imbalance between its General Fund budgetary revenues and expenditures, which the Commonwealth has been required to finance with debt. This imbalance reached its highest historical level of $3.154 billion in fiscal year 2009, when revenues were $7.710 billion and expenditures were $10.864 billion. Since then, the Commonwealth has been able to reduce its budget deficit every year, except fiscal year 2012, through various measures designed to increase revenues and reduce expenditures.

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

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

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

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

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

| Fiscal Year | Total Revenues[1] [2] | Total Expenditures[7][8][9] | Deficit |
|---|---|---|---|
| 2009 | $7,825 | $10,689 | $(2,864) |
| 2010 | $8,032[3] | $10,756 | $(2,724) |
| 2011 | $8,343[4] | $10,144 | $(1,801) |
| 2012 | $8,783 | $11,158 | $(2,375) |
| 2013 | $8,664[5] | $9,974 | $(1,310) |
| 2014 * | $9,142[6] | $10,011 | $(869) |

*Preliminary and unaudited; subject to change.

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

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

(3) Includes $201 million from the sale of securities in the PRIFA corpus account.

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

(5) Includes (i) $242 million in excess funds transferred from the Redemption Fund to the General Fund and (ii) $126 million of excess funds transferred from COFINA to the General Fund.

(6) Includes $80 million of excess funds transferred from COFINA to the General Fund.

(7) Includes General Fund Budget total expenditures of $9.927 billion, $9.640 billion, $9.075 billion, $9.911 billion, $8.938 billion and $9.168 billion (which excludes $162 million for the payment of debt service on general obligation bonds) for fiscal years 2009 through 2014, respectively.

(8) Includes the transfer of rental payments made by the Commonwealth to PBA for properties leased by the Government of $330 million, $251 million, $267 million, $331 million, and $205 million for fiscal years 2009 through 2013, respectively. Note that in fiscal year 2014, these payments were included in the approved budget.

(9) Includes (i) debt service for general obligation bonds of $414 million, $865 million, $802 million, $849 million, $831 million and $843 million for fiscal years 2009 through 2014, respectively, and (ii) debt service for appropriations bonds of $18 million and $67 million for fiscal years 2009 and 2012, respectively.

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

**Financial Condition of Selected Component Units**

Several public corporations and instrumentalities have traditionally relied on subsidies or other transfers from the General Fund to fund a portion of their operations. The current Administration has announced a policy of requiring its instrumentalities to achieve self-sufficiency in the near future. Certain of these instrumentalities, including the Puerto Rico Health Insurance Administration ("PRHIA"), the Puerto Rico Medical Services Administration ("PRMSA"), the Puerto Rico and Municipal Islands Maritime Transport Authority ("MIMTA"), the Puerto Rico Metropolitan Bus Authority ("PRMBA") and the University of Puerto Rico ("UPR"), provide essential services to the residents of the Commonwealth and rely heavily on General Fund appropriations to fund their day to day operations. Others, like the Public Buildings Authority ("PBA"), provide essential services to the Commonwealth's government, which are in turn necessary to provide essential services to residents.

The General Fund budget for fiscal year 2015 included approximately $892 million in appropriations to PRHIA, $27 million to PRMSA, $881 million to UPR, $20 million to MIMTA and $9 million to PRMBA (which also receives $9.6 million in cigarette taxes). The fiscal year 2015 General Fund budget also includes $40 million in additional appropriations for mass transit services, of which $20.4 million have been used to date to subsidize MIMTA and PRMBA during the fiscal year. In addition, the General Fund budget for fiscal year 2015 includes rent payments of $366 million payable to PBA. Notwithstanding the Commonwealth's support, certain of these public corporations suffer from significant annual operating losses and carry material amounts of accounts payable (particularly to other governmental entities such as the State Insurance Fund, the Employees Retirement Systems, PREPA and PRASA). If the Commonwealth's financial condition does not improve, it may be unable to continue to support these operations at the same level without taking action to reduce other expenses or increase revenues. This may result in reduced services to the Commonwealth population. However, some of the services provided by these public corporations are essential to maintain health, public safety and welfare, which may result the Commonwealth prioritizing the funding of such services over financial or other obligations.

*PRHIA*

The Commonwealth, through PRHIA, provides health insurance coverage to approximately 1.6 million qualifying (generally low-income) residents of Puerto Rico. The cost of this health insurance program is very significant, totaling $2.5 billion for the year ended June 30, 2014.

The following table presents selected financial data for PRHIA for fiscal years 2014 and 2013:

| | June 30, 2014 | June 30, 2013 |
|---|---:|---:|
| Average insured lives | 1,600,000 | 1,597,000 |
| Federal reimbursements | $1,283,747,024 | $1,093,733,430 |
| Cost of medical premiums and claims | $2,494,805,333 | $2,335,196,086 |
| Federal funds effective share | 51.46% | 46.84% |
| Decrease in net position for the year | ($59,092,691) | ($16,722,683) |

The following table presents selected data from PRHIA's financial statements for fiscal years 2012 through 2014:

| | 6/30/14 | 6/30/13 | 6/30/12 |
|---|---|---|---|
| General fund appropriations | $894,657,000 | $887,724,800 | $945,033,000 |
| Federal reimbursements | 1,283,747,024 | 1,093,733,430 | 1,104,658,113 |
| Other contributions | 291,958,347 | 312,456,159 | 255,466,047 |
| Interest and other | 40,726,979 | 61,836,272 | 1,202,755 |
| Total revenues | $2,511,089,350 | $2,355,750,661 | $2,306,359,915 |
| | | | |
| Total expenses | $2,570,182,041 | $2,372,473,344 | $2,182,011,596 |
| Increase (decrease) in net position | ($59,092,691) | ($16,722,683) | $124,348,319 |
| Amounts due to suppliers and others | $450,941,483(1) | $290,979,783 | $335,218,540 |
| Amounts due to other governmental agencies | $201,595,435(2) | $190,600,357 | $190,765,279 |

(1) As of June 30, 2014, PRHIA had a $100 million line of credit with a syndicate of commercial banks with an outstanding balance of $83 million. That line of credit was replaced with a $100 million line of credit from GDB that had an outstanding balance of $100 million as of December 31, 2014 and was fully paid by March 31, 2015.
(2) On March 14, 2011, PRHIA entered into a Credit Agreement with GDB in order to pay its obligations to insurers prior to fiscal year 2010. The principal and interest under the Credit Agreement will be paid with General Fund appropriations.

General Fund appropriations for fiscal year 2015 are $892 million. Presently, PRHIA's management is projecting a cash balance of approximately $8 million at June 30, 2015.

A substantial portion of the cost of the Commonwealth's health insurance program is currently paid by the federal government and funded principally by non-recurring funding provided pursuant to the federal Patient Protection and Affordable Care Act (the "Affordable Care Act" or "ACA"), as well as recurring Medicaid and Children's Health Insurance Program ("CHIP") funds, which in the case of the Commonwealth are capped at a level lower than that applicable to the states (which are not capped).

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

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

In addition to the exhaustion of ACA funding, as of March 31, 2015 PRHIA owes approximately $140 million in recorded and unpaid claims under the previous Third Party Administrator ("TPA") model. Furthermore, the actuarially determined incurred but not reported ("IBNR") liability for claims not yet received is approximately $193 million.

PRHIA had a $100 million line of credit with GDB that expired on March 31, 2015, and was not renewed. (This line of credit replaced a similar line of credit with a syndicate of commercial banks.) The GDB line of credit was used to advance to PRHIA funds that were used to pay for medical claims which are subject to federal reimbursement, and was paid with such federal reimbursement as well as with PRHIA's local funds. PRHIA's lack of a credit facility and its transition from a Third Party Administrator to a Managed Care Organization ("MCO") model has exacerbated PRHIA's liquidity needs because, in the latter model, it is customary to pay related premiums during the first days of each month. The Center for Medicaid and Medicare Services ("CMS") agreed with PRHIA to provide its share of federal funds upon availability of local funds on a weekly basis in order to complete the required payments to the MCO's. The requirement to pay premiums the first days of the month, coupled with the need to fund legacy claims under the Third Party Administrator model, results in a financing need of approximately $150 million. If PRHIA is unable to secure funding or financing for this financing gap and/or if the Commonwealth's financial situation precludes it from continuing supporting the Commonwealth health insurance plan, PRHIA might be unable to fulfill its financial and contractual obligations. In order to ensure continuity of services, PRHIA reached a preliminary agreement with the five private insurance providers, whereby PRHIA will be paying throughout the month the premiums owed to the insurers (as opposed to paying the entire amount during the first days of the month).

Other challenges facing the PRHIA are as follows:

- CMS announced that there will be a reduction of approximately 11% in Medicare Advantage funding for Puerto Rico in 2016. Such reductions to the Medicare Advantage rates would impact the ability of the Medicare Advantage plans to assume the costs of covering the higher-need dual eligible population (approximately 250,000 beneficiaries) covered through PRHIA's "Platino" program. Medicare Advantage subsidizes the costs of the "Platino" program from the rates paid through Medicare. If the Medicare Advantage plans cannot subsidize the costs of covering the "Platino" program, PRHIA's costs for calendar year 2016 for this population would increase from the current $20 to $30 million per year to $120 to $150 million per year unless benefit reductions are made.

- Under newly established "Modified Adjusted Gross Income" or "MAGI," standards, the number of Commonwealth residents who are Medicaid-qualified would likely be reduced and their healthcare costs would therefore need to be covered by the Commonwealth without federal reimbursement. The Puerto Rico Health Department and its Medicaid office are responsible for establishing eligibility standards for the Government health plan and therefore are responsible for implementing MAGI. If the Commonwealth decides to continue covering this population under the Government health plan, it is estimated that this may represent an additional cost to the General Fund of $138 million.

There are approximately 180,000 insured lives for which the Commonwealth covers the full amount of their insurance costs as they do not qualify for reimbursement from federal funds. The estimated annual costs for this population are approximately $340 million, which are paid solely by the Commonwealth. In light of all the financial challenges facing the government health plan, the Commonwealth will need to decide if it can afford to continue funding these costs.

The fiscal stability of the Commonwealth's health insurance program is one of the most significant budgetary challenges facing the Commonwealth, especially if neither the availability of ACA funds is renewed nor the CAP imposed on Medicaid matching funds is removed. In view of the current funding disparity between the Commonwealth with respect to the states, the Commonwealth is intensifying its efforts to promote Congress to renew ACA funding. The Resident Commissioner is also involved in these efforts and recently members of the private and public sector formed the Puerto Rico Healthcare Crisis Coalition. However, it is not possible to predict the likelihood that such efforts will succeed. Thus, the Commonwealth will continue evaluating the fiscal structure of the program taking into consideration the current federal funding depletion estimates. To the extent these efforts are unsuccessful; it is unlikely that the Commonwealth would be able to assume a significantly higher portion of the cost of the health insurance program. If the Commonwealth is unable to reduce these costs, it may be required to adopt some of the emergency measures described above in "RISK FACTORS - *The Commonwealth may need to implement administrative and emergency measures in fiscal year 2016 and thereafter, which could include a moratorium on the payment of debt service or debt adjustment."*

*PRMSA*

PRMSA is a public corporation adhered to the Puerto Rico Department of Health that operates and administers the centralized health services offered by the member institutions and consumers of the complex known as the Puerto Rico Medical Center. Historically, PRMSA has incurred significant operating losses. The Commonwealth includes in its budget a legislative appropriation to partially offset PRMSA's operating losses. PRMSA received approximately $27 million, $51 million, $47 million and $24 million during fiscal years 2015, 2014, 2013 and 2012, respectively, as financial support from the Commonwealth's General Fund. Its operating revenues for fiscal years 2014, 2013 and 2012 were $174 million, $158 million and $146 million, respectively. PRMSA suffered operating losses (without considering depreciation and interest expense) during fiscal years 2014, 2013 and 2012 of $61 million, $72 million and $48 million, respectively. Although PRMSA's management has taken measures to reduce its operating deficit, additional measures will be required in order to keep providing continuous services at the medical center. In addition, if the Commonwealth's financial situation precludes it from continuing supporting PRMSA, it could affect continuity of services at the Puerto Rico Medical Center.

PRMSA has experienced significant increases in amounts due to suppliers and other governmental agencies from 2012 to 2014. Amounts due to suppliers and others increased from $69 million at June 30, 2012 to $97 million at June 30, 2014; and the balances payable to other governmental entities increased from $282 million at June 30, 2012 to $391 million at December 31, 2014. Presently, PRMSA's management is projecting a cash balance of approximately under $1 million at June 30, 2015.

*MIMTA*

MIMTA is a public corporation that operates the maritime transportation services between the municipalities of San Juan, Cataño, Fajardo, Vieques, and Culebra. MIMTA is funded principally through General Fund legislative appropriations and federal funds. MIMTA received approximately $20 million, $26 million, $24 million and $28 million during fiscal years 2015, 2014, 2013 and 2012, respectively, as financial support from the Commonwealth's General Fund. The fiscal year 2015 General Fund budget also includes $40 million in additional appropriations for mass transit services, which have been used in part to subsidize MIMTA and PRMBA. Its operating revenues (principally passenger and cargo fares) for fiscal years 2014, 2013 and 2012 were $5.2 million, $5.9 million and $4.7 million, respectively. In the past, the PRHTA and the Puerto Rico Ports Authority have also been sources of funds to MIMTA. For fiscal years 2014, 2013 and 2012, the MIMTA had operating losses (without considering depreciation and interest expense) of $41.9 million, $45.3 million and $36.2 million, respectively.

MIMTA has experienced significant increases in amounts due to suppliers and other governmental agencies from 2012 to 2014. The amounts due to suppliers and others increased from $11.8 million at June 30, 2012 to $16.2 million at June 30, 2014; and the balances payable to other governmental entities increased from $4.1 million at June 30, 2012 to $9.2 million at December 31, 2014. Presently, MIMTA's expenses have exceeded the assigned legislative appropriations. In order to cover this deficiency, OMB has reprogrammed $2.7 million in budget appropriations under its control.

*PRMBA*

The PRMBA provides public transportation to passengers within the San Juan Metropolitan Area. The principal sources of funds for the operations of PRMBA are Commonwealth General Fund appropriations, certain assigned taxes (cigarette taxes) and federal funds. PRMBA received approximately $9 million, $42.2 million, $43.4 million and $61.6 million during fiscal years 2014, 2013 and 2012, respectively, from Commonwealth General Fund appropriations. The fiscal year 2015 General Fund budget also includes $40 million in additional appropriations for mass transit services, which have been used in part to subsidize PRMBA and MIMTA during the fiscal year. Its operating revenues (principally passenger fares, advertising and rental income) for fiscal years 2014, 2013 and 2012 were $4.9 million, $5.8 million and $5.4 million, respectively. For fiscal years 2014, 2013 and 2012, the PRMBA had operating losses (without considering depreciation and interest expense) of $61.5 million, $71.7 million and $86.0 million, respectively.

PRMBA's amounts due to suppliers and other governmental agencies have increased materially from 2012 to 2014. Accounts payable to suppliers increased from $2.9 million at June 30, 2012 to $7.8 million at June 30, 2014; and the balances payable to other governmental entities increased from $26.8 million at June 30, 2012 to $57.2 million at December 31, 2014. Governmental entities to which PRMBA owes money include the Treasury Department, the State Insurance Fund Corporation, the Retirement Systems Administration, PREPA and PRASA. Presently, PRMBA's expenses have exceeded the assigned legislative appropriations. In order to cover this deficiency, OMB has reprogrammed $17.7 million in budget appropriations under its control.

The Integrated Transport Authority ("PRITA") is a new public corporation intended to combine the operations of MIMTA, PRMBA and the Urban Train ("UT"), which was being financially supported by PRHTA. PRITA's management has been working on the required federal approvals in order to transfer the above-mentioned operations to PRITA. These operations have a history of significant losses. Although the enabling legislation of PRITA assigns dedicated revenues to PRITA, there is no assurance that the combined operations would be financially self-sufficient.

*UPR*

The University of Puerto Rico ("UPR") has an essential role as the Commonwealth's sole public undergraduate and postgraduate higher education provider and a key contributor to the local economy through its academic, medical and research programs.

Approximately 78% of the UPR's funding is derived from non-operating revenues, including Commonwealth General Fund appropriations and Federal grants (in particular, the Federal Pell Grant Program). Under current law, UPR's General Fund appropriations for any year equal 9.6% of the average of the General Fund revenues for the two prior years. However, the Fiscal Sustainability Act froze UPR's appropriations at their fiscal year 2014 level for three years. UPR's General Fund appropriations for fiscal years 2015, 2014, 2013 and 2012 were $881 million, $874 million, $834 million, and $763 million, respectively.

Its operating revenues (principally tuition) for fiscal years 2014, 2013 and 2012 were $243 million, $279 million and $321 million, respectively. UPR had operating losses (without considering depreciation, interest expense and Commonwealth grants and contracts) during fiscal years 2014, 2013 and 2012 of $1.041 billion, $1.005 billion and $953 million, respectively. UPR's amounts due to third parties increased from $328 million at June 30, 2012 to $353 million at June 30, 2014.

Balances payable to governmental entities increased from $112 million at June 30, 2012 to $124 million at June 30, 2014. Presently, UPR's management is projecting a cash balance of approximately $110 million at June 30, 2015. The UPR has limited ability to raise operating revenues due to the economic and political related challenges of maintaining enrollment and increasing tuition.

*PBA*

PBA constructs, purchases or leases office, school, health, correctional and other facilities to departments, public corporations and instrumentalities of the Commonwealth. Ninety five percent of PBA's revenues are derived from rents paid by governmental agencies through the General Fund budget. These General Fund rent allocations amounted to $366 million, $391 million, $186 million and $235 million for fiscal years 2015, 2014, 2013 and 2012, respectively. Rent allocations payable from the General Fund were materially lower for fiscal years 2013 and 2012 because a portion of such rental payments were refinanced with GDB lines of credit or long-term debt. Its operating revenues (principally rent payments) for fiscal years 2014, 2013 and 2012 were $413 million, $186 million and $235 million, respectively. Accounts payable to PBA's suppliers decreased from $91 million at June 30, 2012 to $69 million at June 30, 2014. Balances payable to other governmental entities decreased from $357 million at June 30, 2012 to $234 million at June 30, 2014. As of the date hereof, PBA has a cash balance of approximately $4 million. PBA's cash balance as of June 30, 2015 will depend on whether it receives the rent payable by its government tenants on a timely basis. If the Commonwealth's financial situation precludes it from fully complying with its rent obligations to PBA, PBA may be unable to meet its financial and contractual obligations, which include approximately $4.1 billion in bonds guaranteed by the Commonwealth.

## Update on the Condition of the Retirement Systems

A significant component of the Commonwealth's budget is the cost of its three principal retirement systems, the Employees Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (the "Employees Retirement System"), the Puerto Rico System of Annuities and Pensions for Teachers (the "Teachers Retirement System") and the Commonwealth Judiciary Retirement System (the "Judiciary Retirement System"). These pension systems are severely underfunded. See RETIREMENT SYSTEMS in the Commonwealth Report.

*Employees Retirement System*. The Employees Retirement System's latest actuarial valuation, as of June 30, 2013, calculated accounting results for pension benefits under Governmental Accounting Standards Board No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans" ("GASB 25"). This actuarial valuation reflected an unfunded actuarial accrued liability (including basic and system administered benefits) of $22.981 billion and a funded ratio of 3.1%. The Employees Retirement System's actuarial valuation as of June 30, 2014 will differ from the actuarial valuation as of June 30, 2013, since, among other reasons, it will be the first valuation under GASB Statement No. 67, "*Financial Reporting for Pension Plans*" ("GASB 67"), which replaced GASB 25. GASB 67 specifies certain significant changes for financial reporting purposes, including but not limited to (a) calculation of plan liabilities based on the "entry age normal" method (compared to the "projected unit credit" method used in the prior valuation), (b) calculation of a "depletion date" based on a projection as to the length of time assets will cover projected benefit payments under certain assumptions, and (c) for purposes of valuing the plan's liabilities after the depletion date, use of a discount rate tied to a municipal bond index. GASB 67 also introduces certain new terminology, including: (i) Total Pension Liability, which is the actuarial accrued liability calculated in accordance with the new GASB 67 requirements, (ii) Fiduciary Net Position, which is the market value of plan assets, net of liabilities (in the case of the Employees Retirement System, Fiduciary Net Position is also equivalent to the previously reported actuarial value of assets), and (iii) Net Pension Liability, which is calculated as Total Pension Liability less Fiduciary Net Position, and is equivalent to the unfunded actuarial accrued liability.

The Employees Retirement System's actuaries have completed a preliminary actuarial valuation report as of June 30, 2014, that complies with GASB 67. The preliminary valuation reflects an increase in pension liabilities and a decrease in the funded level for financial reporting purposes. As of June 30, 2014, the preliminary valuation reflects a Total Pension Liability of $30.2 billion, a Fiduciary Net Position of $210 million (total assets of $3.5 billion net of liabilities of $3.3 billion, consisting principally of $3.1 billion in pension obligation bonds), and a Net Pension Liability of $30.0 billion. The Fiduciary Net Position as a percentage of Total Pension Liability (the "funded ratio") is 0.7%. The prior valuation used an investment return assumption of 6.40% per year and, under GASB 25, this assumed return was also used to discount the projected pension benefits to determine the actuarial accrued liability. The new actuarial valuation reflects an increase in the investment return assumption to 6.75% per year but, under GASB 67, the investment return assumption is an input in the calculation of the single equivalent rate that is used to discount pension benefits to determine the Total Pension Liability. The GASB 67 discount rate used in the preliminary valuation report as of June 30, 2014 is 4.29% per year.

For purposes of calculating the projected GASB 67 "depletion date", the asset basis used by the actuaries is the System's net assets, totaling approximately $210.3 million (i.e., total assets of approximately $3.5 billion less the pension obligation bonds and other liabilities of approximately $3.3 billion). On this basis, no projection is needed since net assets are exhausted in fiscal year 2015. The preliminary valuation is still subject to review and may change.

In 2013, the Commonwealth enacted legislation that reformed the Employees Retirement System by, among other measures, reducing benefits, increasing employee contributions, and, in the case of active employees who were entitled to the defined benefits program, replacing most of the defined benefit elements of the system with a defined contribution system. Based on the statutory funding requirements prior to this reform, the annual benefit payments and administrative expenses of the System were significantly larger than the member and employer contributions made to the System. As a result, investment income and the System's assets were being used to cover the negative cash flow, and the System's gross assets were projected to be exhausted by fiscal year 2019. The reform intended to address the Commonwealth's future cash flow needs and "pay-as-you-go" requirements, while recognizing that the System would continue to have a large unfunded actuarial accrued liability and a low funded ratio. As such, the reform was intended to provide enough cash for the System to be able to pay benefits (as amended through the reform) and debt service on the pension obligation bonds, while maintaining projected System gross assets at no less than $1 billion at all times.

In order to achieve this goal, the reform contemplated that the Commonwealth and other participating employers would have to provide additional annual funding above the statutorily prescribed contributions (the "Additional Uniform Contribution"). Initially, it was projected that the Additional Uniform Contribution required to be made by the employers through fiscal year 2032 was approximately $140 million. The fiscal year 2014 Additional Uniform Contribution was subsequently revised by Act 244-2014 to $120 million, of which approximately $78 million was allocable to the Central Government, to be funded from the General Fund, and the balance of which was allocable to the municipalities and participating public corporations. As a long-term plan, it was recognized that constant monitoring would be required to ensure that the System remained on track to meet the reform's goals.

Timely payment of the Additional Uniform Contribution was a critical component of the reform in order for the System to be able to make payments as they come due without depleting all of its assets first. However, as a result of continued budget deficits in fiscal years 2014 and 2015, the Commonwealth and other participating employers have been unable to make the Additional Uniform Contribution required for these fiscal years (other than $33 million and $5.8 million paid for fiscal years 2014 and 2015, respectively, by public corporations and municipalities). In February 2015, the System's actuaries recalculated the Additional Uniform Contribution for fiscal year 2016 and subsequent years. Based on certain assumptions (which do not account for any fiscal adjustment that the Commonwealth may undertake to address its fiscal challenges), the projected Additional Uniform Contribution for fiscal year 2016 and subsequent years has increased to approximately $352 million (of which approximately $216 million corresponds to the Commonwealth's central government, to be funded from the General Fund and the remaining portion corresponds to the participating public corporations and municipalities). The increase in the Additional Uniform Contribution from the initially projected levels is the result of multiple factors, but the most important ones are the decline in the number of active members and the associated payroll since June 30, 2012, and the three-year salary freeze implemented through Act 66-2014. While these factors result in payroll and related cost savings for the Commonwealth and other participating employers, from the perspective of the System, its projected funding decreases since statutory contributions are based on a percentage of payroll and, thus, a lower level of payroll generates fewer contributions, causing the Additional Uniform Contribution to increase to compensate for the reduction.

The preliminary actuarial valuation as of June 30, 2014, again emphasizes that if the Additional Uniform Contribution and the other statutorily prescribed employer contributions are not paid in full on an annual basis, the Employees Retirement System will continue to rapidly exhaust its gross assets. The Employees Retirement System currently projects that if the Commonwealth and other participating employers fail to make the Additional Uniform Contribution at the level determined by the actuaries, the System's gross assets will be depleted by fiscal year 2021. However, given that the Employees Retirement System's assets include a significant amount of loans to members, which may not be readily sellable, the System may face liquidity problems sooner that the projected full depletion date of its assets. The funding needs of the Employees Retirement System result in additional fiscal challenges for the Commonwealth.

*Teachers Retirement System*. The Teachers Retirement System's latest actuarial valuation, as of June 30, 2013, under GASB 25, reflected an unfunded actuarial accrued liability (including basic and system administered benefits) of $10.345 billion and a funded ratio of 15.6%. The Teachers Retirement System's actuaries have completed a preliminary actuarial valuation report as of June 30, 2014, that complies with GASB 67. The preliminary valuation reflects an increase in pension liabilities and a decrease in the funded level for financial reporting purposes. As of June 30, 2014, the preliminary valuation reflects a Total Pension Liability of $14.8 billion, a Fiduciary Net Position of $1.7 billion, and a Net Pension Liability of $13.1 billion. The Fiduciary Net Position as a percentage of Total Pension Liability is 11.5%. The GASB 67 discount rate used in the preliminary valuation report as of June 30, 2014 is 4.33% per year. The preliminary valuation is still subject to review and may change.

The actuaries have also projected the date of depletion for the Teachers Retirement System under the methodology specified in GASB 67 as of June 30, 2014, assuming, given current budgetary constraints, that the Uniform Contribution and the Annual Additional Contribution is not paid in future fiscal years. Based on this and various other assumptions, the projected date of depletion of the Teachers Retirement System measured on the GASB 67 basis is expected to occur during fiscal year 2019. The date of depletion projection under the GASB 67 basis is not the same as the date that the System would be expected to exhaust assets as it differs from a cash flow projection.

The Teachers Retirement System is a mature system with a significant retiree population. Based on statutory funding requirements prior to the reform described below, the annual benefit payments and administrative expenses paid by the System are significantly larger than the member and employer contributions made to the System. As a result, investment income and the System's assets are being used to cover the negative cash flow, and the System's assets are expected to continually decline until exhaustion.

As with the Employees Retirement System, the Commonwealth enacted legislation in 2013 to carry out a comprehensive reform of the Teachers Retirement System that, together with certain additional contributions, was projected, based on actuarial assumptions, to allow the System to make benefit payments when due without depleting all of its assets first. While most of this legislation was struck down by the Puerto Rico Supreme Court on constitutional grounds, the Commonwealth is still responsible for making certain additional annual contributions to the System. The legislation provides for two classes of additional contributions by the Commonwealth to the System: (i) a Teacher's Justice Uniform Contribution (the "Uniform Contribution") from the General Fund to the System of $30 million in each of fiscal years 2017 and 2018 and $60 million thereafter until fiscal year 2042, and (ii) an Annual Additional Contribution commencing on fiscal year 2019 and continuing until fiscal year 2042 (the "Annual Additional Contribution") equal to the amount determined by the actuaries as necessary to prevent the projected value of the gross assets of the System from falling below $300 million during any subsequent fiscal year. In April 2015, the System's actuaries prepared an actuarial study to determine an estimate of the Annual Additional Contribution and, based on various assumptions, projected that the Annual Additional Contribution for fiscal year 2019 and each fiscal year thereafter would be approximately $450 million. The actuarial study notes that if the Annual Additional Contribution is not paid in full during the intended fiscal years, the amount would increase in the following years. The actuaries also noted that if the System were unable to sell certain illiquid assets (consisting primarily of loans to members), currently amounting to approximately $450 million, the System may face liquidity issues since its assets are projected to fall below the $450 million level during fiscal year 2018, one year before the first payment of the Annual Additional Contribution. The funding needs of the Teachers Retirement System result in additional fiscal challenges for the Commonwealth.

*Judiciary Retirement System*. The Judiciary Retirement System's latest actuarial valuation, as of June 30, 2013, under GASB 25, reflected an unfunded actuarial accrued liability (including basic and system administered benefits) of $357.7 million and a funded ratio of 14.2%. The Judiciary Retirement System's actuaries have completed a preliminary actuarial valuation report as of June 30, 2014, that complies with GASB 67. The preliminary valuation reflects an increase in pension liabilities and a decrease in the funded level for financial reporting purposes. As of June 30, 2014, the preliminary valuation reflects a Total Pension Liability of $504.4 million, a Fiduciary Net Position of $62.1 million, and a Net Pension Liability of $442.3 million. The Fiduciary Net Position as a percentage of Total Pension Liability (the "funded ratio") is 12.3%. The prior valuation used an investment return assumption of 6.30% per year and, under GASB 25, this assumed return was also used to discount the projected pension benefits to determine the actuarial accrued liability. The new actuarial valuation reflects a decrease in the investment return assumption to 5.35% per year. Under GASB 67, the investment return assumption is an input in the calculation of the single equivalent rate that is used to discount pension benefits to determine the Total Pension Liability. The GASB 67 discount rate used in the preliminary valuation report as of June 30, 2014 is 4.30% per year.

In 2013, the Commonwealth enacted a comprehensive reform of the Judiciary Retirement System that was intended, based on actuarial assumptions, to allow the System to make benefit payments when due without depleting all of its assets first. While most of this legislation was struck down by the Puerto Rico Supreme Court on constitutional grounds, the Commonwealth is still responsible for making certain annual additional contributions to the System. The legislation provides that the Commonwealth will request an actuarial report to determine the amount of the annual additional contribution the Commonwealth would have to make, commencing in fiscal year 2015, in order to avoid the projected gross assets of the System during any subsequent fiscal year from falling below $20 million. The first annual additional contribution for fiscal year 2015 has been determined at $11.6 million, and is due by June 30,

2015. For fiscal year 2016, the annual additional contribution will be $12.1 million, due by June 30, 2016.

The actuaries have also projected the date of depletion for the Judiciary Retirement System under the methodology specified in GASB 67. This projection does not include the annual additional contributions described above. Based on various assumptions, the projected date of depletion of the Judiciary Retirement System measured on the GASB 67 basis is expected to occur during fiscal year 2018. The date of depletion projection under the GASB 67 basis is not the same as the date that the System would be expected to exhaust assets as it differs from a cash flow projection. If the annual additional contributions are not made, the System will continue to be rapidly defunded and its gross assets will be exhausted before the end of the decade.

**Third-Party Liquidity Analysis of the Commonwealth for the Balance of Fiscal Year 2015 and Fiscal Year 2016**

As mentioned above, GDB, in its role as fiscal agent to the Commonwealth and its instrumentalities, has hired Conway to perform a liquidity analysis of the Commonwealth, assist with the implementation of measures to improve cash management and forecasting procedures, and provide assistance to the Treasury Department in the development of short and medium-term cash flow projections. Conway has also performed a limited review of certain other Commonwealth funds and component units, and this limited review has now been expanded to include a more detailed review of such funds and units.

As part of the engagement, Conway has provided liquidity projections for the remainder of the current fiscal year and the following fiscal year of the Commonwealth's cash balance in the Concentration Account, in which the Treasury Department deposits and disburses amounts related to several funds, including receipts, among others, from taxes and charges for services, collections made on behalf of certain component units, receipts of most Federal funds, and net receipts from new debt issuances and pension contributions and disbursements of pension benefits for the three principal retirement systems. It is important to note that Conway's analysis was limited to funds available to the Treasury Department in its Concentration Account at GDB and did not factor other potential sources of liquidity available to the Commonwealth, such as cash in the Commonwealth's depositary accounts other than the Concentration Account (including accounts holding funds for capital projects of the Commonwealth), agency deposits at third party financial institutions and cash and other liquid assets held by GDB.

Conway's work product is preliminary, ongoing and subject to review by GDB and the Treasury Department and is expected to change due to, among other things, such review, potential legislative and administrative initiatives and actual results for fiscal year 2015. For example, revenue results for the months of March and April were higher than Conway's initial projection and, as a result, Commonwealth liquidity projections for fiscal year 2015 were revised accordingly as of the end of April. Conway is expected to update all of its projections during May 2015 to account for April 2015 actual results.

Conway's base projections discussed herein are based on various assumptions and estimates and, importantly, do not take into consideration the impact of (i) certain revenue raising and expense reduction initiatives the Commonwealth has identified to reduce the fiscal year 2015 General Fund deficit, (ii) any new tax revenue measures and expense reduction measures on the fiscal year 2016 budgetary and liquidity picture and (iii) liquidity from new financing sources, including the issuance of TRANs. For example, as described in "Fiscal Year 2015 Budget Deficit" under FISCAL CONDITION, the Commonwealth has identified revenue-raising and expense reduction measures to reduce the fiscal year 2015 General Fund budgetary shortfall. OMB is also identifying General Fund expense reductions for purposes of configuring the fiscal year 2016 General Fund budget.

*Conway's Preliminary Liquidity Projections for Fiscal Year 2015.* Conway's analysis of projected cash balances in the Concentration Account for fiscal year 2015 show that a bank cash deficit of approximately $220 million would occur during June 2015 (inclusive of certain identified remediation measures, including the State Insurance Fund dividend and the tax prepayment initiatives). Conway further reconciled the projected book cash overdraft at the Concentration Account by adjusting the bank cash balance to take into account outstanding checks (whether held at Treasury or floating) and deposits in transit from other accounts.

Conway highlighted in its report that one of the primary drivers of the projected cash deficit is the projected shortfall in budgeted revenue for fiscal year 2015, which, Treasury estimates, as of April 30, 2015, at approximately $651 million. Although the Commonwealth has implemented or is currently implementing corrective measures that it expects will reduce the budget deficit to $191 million, Conway has noted that some of the corrective measures contemplated are subject to implementation risks and certain revenue enhancements and expense reduction measures may not fully materialize in the remaining months of fiscal year 2015.

In addition, Conway identified additional liquidity risks to the Commonwealth ranging from $400 million to $1.85 billion, although not all of these would have a cash effect on fiscal year 2015. These liquidity risks relate to several component units, including financing needs of the Puerto Rico Health Insurance Administration, cash disbursements related to accounts payable from prior years, earmarked funds that are commingled in the Concentration Account and other payables from the General Fund to certain component units and governmental funds.

For purposes of its report, Conway included the budgetary funds, federal funds, and other funds managed by the Commonwealth (including agencies with their own resources and treasuries) within the General Fund. Conway estimated General Fund accounts payable and accrued liabilities as of June 30, 2014 at approximately $1.529 billion, of which $982 million are short-term payables. Approximately $491 million of such short-term accounts payable have a corresponding account receivable from the Federal Government under existing contracts and grants (receipts are collected on a reimbursement method). Long-term accounts payable were approximately $547 million, which includes contingent liabilities without a repayment schedule and which are not expected to affect the liquidity of the Commonwealth in the short-term. In addition, Conway estimated, as of June 30, 2014, (a) $457 million in amounts due to component units without a defined repayment schedule, (b) $552 million in income tax payables that represent actual refunds expected to be claimed and paid during fiscal year 2015 and (c) $200 million of TRANspayable to GDB, which were paid in July 2014. Conway's report included other liabilities that are not expected to affect the Commonwealth's short-term liquidity and are reported only for accounting and financial statement purposes. The above figures include estimates and assumptions regarding certain balance sheet items that may be materially different from actual results and those amounts presented in the Commonwealth financial statements.

The Commonwealth is evaluating the impact of certain short-term administrative measures to deal with the projected liquidity shortfall. Conway's analysis indicates, however, that in the absence of new TRANs or other cash flow financing for fiscal year 2016, the implementation of such measures would not be sufficient, by themselves, to avoid full cash depletion at the Treasury's Concentration Account by September 2015. At that time, absent new financing from GDB or third parties, Conway projects that the Commonwealth would not be in a position to continue funding all governmental programs and services while continuing to meet all of its debt service obligations in a timely manner.

*Conway's Fiscal Year 2016 Projections.* For fiscal year 2016, Conway's projections reflect a cash deficit at the General Fund, before the implementation of any revenue or expense initiatives, of approximately \$2.4 billion, resulting from assumed revenues of approximately \$8.3 billion and assumed expenditures of approximately \$10.7 billion. These projections will have to be updated if any new tax revenue measures are enacted; and when OMB can provide the additional cost control measures that it will propose as part of the adoption of the fiscal year 2016 budget.

In addition, Conway identified additional liquidity risks ranging from \$100 million to \$500 million for fiscal year 2016 due to potential cash disbursements related to accounts payable from prior years. Conway's analysis further assumed that days payable on outstanding accounts payable remains flat. Conway's revenue forecast for fiscal year 2016 is that, absent new revenue measures, General Fund revenues would decrease by approximately 5.9% as a result of adjustments for one-time revenues during fiscal year 2015, including revenues from non-recurring tax amnesties and the gross profit tax applicable to corporations (which was repealed mid-fiscal year). Conway's assumed disbursements include a repayment of \$300 million for the principal balance of the 2015 TRANs Series C Notes, which is expected to be refinanced by GDB, as well as payment of the \$100 million short-term line of credit extended pursuant to Act 164-2001 by GDB to the Commonwealth during fiscal year 2015, which is expected by Treasury to be repaid in full during fiscal year 2015 or otherwise termed out.

In preparing its analysis, Conway relied on information provided by the Commonwealth and its instrumentalities and, therefore, Conway assumes no responsibility for the accuracy or completeness of such information. Conway's analysis does not constitute an audit in accordance with generally accepted auditing standards or other attestation or review services in accordance with standards established by the American Institute of Certified Public Accountants. Furthermore, Conway's analysis includes estimates and projections that are inherently subject to significant economic and other uncertainties. Actual results may vary materially from such estimates and projections.

*Conway has not participated in the preparation of this Quarterly Report and has no responsibility for its contents, including any cash flow and liquidity projections included herein. Conway is not soliciting or recommending the purchase or sale of securities, or any indications for the purchase or sale of securities, or any other investment decisions.*

# THE ECONOMY

## Gross National Product

According to the Puerto Rico Planning Board's figures, made in April of 2015, Puerto Rico's real gross national product for fiscal years 2013 and 2014 decreased by 0.2% and 0.9%, respectively. Although the forecast for fiscal years 2015 and 2016 has not been made public, the cumulative values for the monthly economic indicators for fiscal year 2015 indicate that the real gross national product for fiscal year 2015 could also show a decrease.

## Employment

According to the Household Survey, during the first nine months of fiscal year 2015, total employment fell by 0.8% as compared to the same period for the prior fiscal year, and the unemployment rate averaged 13.1% compared to 14.7% for the same period of the prior fiscal year. According to the Establishment Survey, total payroll non-farm employment decreased by 1.5% during the first nine months of fiscal year 2015. This reduction is primarily attributable to attrition and to the changes to the Employees Retirement System made pursuant to the 2013 pension reform, which may have induced some government employees to accelerate their retirement. Employment reductions in state and local government employment more than offset increases in private employment during this period.

Every March, in addition to the January data, the Bureau of Labor Statistics publishes the benchmark revision for the payroll employment figures for the previous 21 months. This year the revision corresponded to data of 2014 and to the last three quarters of 2013. The data for 2013 did not change significantly, but the numbers for 2014 implied an average downward revision of 17,300 employees. For that reason, the reduction of total payroll employment for fiscal year 2014 of 1.3% originally reported became after the revision a decline of 2.2% and the no growth situation for the first semester of fiscal year 2015 (0.0%) was revised to a decrease of 2.0%.

## Economic Activity Index

GDB's Economic Activity Index (the "EAI") for February 2015 reflected a 1.6% reduction compared to February 2014. The average cumulative value for the first eight months of fiscal year 2015 showed a reduction of 2.5% compared to the same period of fiscal year 2014. The EAI is a coincident indicator of ongoing economic activity but it does not measure the real GNP annual growth rates. Since the EAI is generated with only four variables (total payroll employment, cement sales, gasoline consumption, and electric power generation), it is more volatile than the real GNP figures. This means that both increments and declines reflected in the EAI amplify the corresponding movements of the real GNP.

The Bureau of Labor Statistics benchmark revisions mentioned above also imply changes on the GDB-EAI. Therefore, the reported decrease of the EAI for fiscal year 2014 of 3.0% has been revised now to a decrease of 3.5%; and the decrease of 1.5% for the first semester of fiscal year 2015 has been revised to a decrease of 2.7%.

**Economic Growth**

Since January 2013, the Commonwealth has embarked on a comprehensive outreach strategy in order to diversify Puerto Rico's economic base, pursue niche strategies such as Aerospace/Aeronautics, and leverage its human capital and fiscal autonomy to attract new investment opportunities. The Government's goal is to protect Puerto Rico's manufacturing core while it transitions its economic ecosystem into a regional service and high technology industrial activities hub.

In terms of specific opportunities within the services sector, Puerto Rico offers a suite of tax incentives such as Laws 20, 22, 273, and 399. Each of these laws meets specific needs for organizations as well as for individual investors. Yet, the interconnectivity of these incentives provides an aggressive service platform which firms can leverage in order to enhance operational efficiencies and better serve their client base. Promotional efforts in several fronts including participating in relevant industry conferences, direct approach and ongoing conversations with investors and service providers have resulted in the following:

- **Law 20 to promote exportation of services.** Approved 415 tax grants, 69 year-to-date, spanning different industries/sectors for the establishment of new export service operations on the island. Top sectors included: (i) Headquarters and Centralized Management Services; (ii) IT related services; (iii) Financial Services; and (iv) Advertising, Public Relations, Commercial Arts and Graphics Services.

- **Law 22 for individual investors.** There is a positive growth trend in new residents with 628 approved tax grants of which 119 have been approved year-to-date.

- **Law 273 International Financial Entities.** Strong growth since 2013 with 6 operating licenses approved in 2013, 9 operating licenses approved in 2014, and 3 operating licenses approved year-to-date. As of December 31, 2014, IFEs had total assets exceeding $430 million.

- **Law 399 International Insurance Center.** Promotional efforts and direct approaches with insurance carriers and underwriters, captive managers and related advisors have resulted in: (i) 15 authorized insurance companies; (ii) over 230 approved segregated asset plans and protected cell arrangements; (iii) total premium income of $149 million for 2013; and (iv) initial estimates for 2014 point towards $180 million in total premium income.

For manufacturing our focus is on (i) retaining existing biopharmaceutical operations and pursuing opportunities in the emerging generic pharmaceuticals and biologics markets, (ii) capturing new opportunities in additional manufacturing segments, and (iii) tapping growth opportunities in the emerging segments of bio-agriculture, aerospace, export services and information technology.

- Dow Agro Sciences has made a multimillion investment to establish a new station for the research of corn and other crops (soy and sunflower) in Puerto Rico. The total estimated capital investment in this project was approximately $60 million, including the land acquisition, construction, and equipment. The new research and development station created approximately 16 new regular and highly skilled full time jobs with an estimated payroll of $1.6 million. Another 300 seasonal farm workers jobs will be generated over the course of activities.

- Infosys BPO, the business process outsourcing subsidiary of Infosys, recently opened its new center on the island. The center will host approximately 250 employees serving worldwide clients. The company chose a 12,000-square feet site in the northern municipality of Aguadilla to run its operations. It will leverage this new center to initially deliver complex order-to-cash business processes for clients in the aviation sector. Infosys BPO is further expanding its footprint in the region to service clients in the federal and government sector, and the healthcare industry.

- AbbVie announced the expansion of one of its existing sites on the island with an estimated investment of $30 million. This expansion will add to Puerto Rico's capabilities as a manufacturing destination for biotechnology and is expected to create up to 100 new jobs over the next two years. The proposed expansion will take place in AbbVie's site located in the northern municipality of Barceloneta. This site is already home to two of the company's state-of-the-art facilities.

- American Industrial Acquisition Corporation ("AIAC") reached an agreement with Merck to acquire its manufacturing facility in Arecibo that was under closing plans. As part of the agreement, AIAC will retain the approximately 200 Merck employees at the Arecibo manufacturing facility. AIAC is an industrial group comprised of sixty manufacturing sites in eighteen countries with over 9,500 employees.

- Silgan Containers opened in Puerto Rico its first manufacturing site in the Caribbean. The company is the largest provider of metal food packaging in the United States. The new facility is located in the municipality of Las Piedras where the company has established long-term agreements with two key customers.

    - Two major aerospace projects continue to advance according to timeline. The development and construction of Lufthansa Technik's first aircraft maintenance, repair and overhaul ("MRO") facility in the Americas is showing significant progress with a great deal of the construction already completed. Also, the Puerto Rico Industrial Development Company and Honeywell Aerospace continue working closely on the construction of an electromagnetic interference (EMI) laboratory that should be completed later this year.

- In 2014, Puerto Rico exports increased by $5.340 billion to $67.2878 billion, 6.8% higher than in 2013. Exports have increased at an average rate of growth of 9.3% during the last four quarters of 2014.

- Exports in the first two months of the first quarter of fiscal year 2015 (Jan-Feb), totaled $12.5087 billion, an increase of 18.4% compared to the first two months of the first quarter of fiscal year 2014.

- In 2014, Puerto Rico retail sales increased by $177.8 million to $37.5707 billion, 0.48% higher than in 2013. Retail sales have increased at an average rate of growth of 1.1% during the last four quarters of 2014.

- Retail sales in January 2015, decreased 2.74% to $3.0620 billion compared to $3.1483 billion in January 2014.

The Tourism Company made a strategic decision to expand its source of visitors beyond the United States and all its efforts, led by research, followed by a well-defined strategic plan and marketing campaign have been directed to that goal.

- Fiscal year 2015 saw record arrivals of cruise ship passengers with an impact on the local economy of approximately $1.6 million.

- Increased air connectivity with new routes as well as recovering lost connections:

    - Regained direct flights to Madrid via Air Europa twice a week.
    - Avianca Airlines expanded weekly capacity between San Juan Luis Muñoz Marín International Airport ("SJU") and El Dorado International Airport in Bogotá ("BOG").
    - Recently announced two weekly flights between San Juan and Cancún, Mexico via Volaris.
    - New routes to Copenhagen, London, Oslo, and Stockholm via Norwegian Airlines starting on November 2015.

- 1,000 new hotel rooms have been finalized taking total hotel rooms available to 15,000 for the first time.

- The newly created Medical Tourism Corporation ("PRMTC") will begin promotional and marketing efforts in our target markets (the United States East Coast, Latin America and the Caribbean) at the end of May with the announcement of the new branding of the destination and the launch of the website. Also, Training courses and visits to providers have been conducted monthly since January 2015. In the coming months we will be certifying more providers. The training courses and the certification is provided by the Medical Tourism Association ("MTA") in collaboration with the PRMTC.

In an effort to continue developing our infrastructure and pursue strategic development projects, the administration has focused on two landmark projects as the Roosevelt Roads Redevelopment and the Port of Ponce revamp:

- The Land Redevelopment Authority ("LRA") completed the request for proposal ("RFP") process for master developers and is engaged in exclusive negotiations with Clark Realty Company. LRA expects to finalize and sign a Master

Development Plan Agreement by end of June 2015. Approximate full long term development investments are set at approximately $3 billion.

- The Port of Ponce Authority has recently concentrated all efforts on obtaining a world-class operator that can operate the Port. To achieve this, the Port of Ponce Authority published a Request for Proposals during October 2014. On February 2015, the Port of Ponce Authority selected *Portek International Pte Ltd* as the company who would operate the entire port facilities. At this time, the Port of Ponce Authority is negotiating a contract with Portek and expects to have a finalized agreement by the end of July 2015.

# DEBT

## Public Sector Debt

The table on the following page presents a summary of the debt of the Commonwealth and its instrumentalities outstanding as of March 31, 2015. The table should be read in conjunction with the information set forth under DEBT in the Base Commonwealth Report. This table includes debt primarily payable from Commonwealth or municipal taxes, Commonwealth appropriations, and rates charged by Commonwealth public instrumentalities for services or products, as well as debt payable from other sources, some of which is set forth in footnote 6 below. Excluded from the table is debt that, if included, would result in double counting, including but not limited to $793 million of outstanding bonds issued by Puerto Rico Municipal Finance Agency to finance its purchase of bonds issued by Puerto Rico municipalities, as well as $5.9 billion of GDB bonds and notes.

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

## Commonwealth of Puerto Rico
## Public Sector Debt
## (in millions)

| | March 31, 2015 |
|---|---|
| Good faith and credit bonds and notes issued by the Commonwealth | $13,055[1] |
| Bonds and notes guaranteed by the Commonwealth's good faith and credit [2] | 5,511 |
| SUBTOTAL - GOOD FAITH AND CREDIT BONDS AND NOTES | 18,566 |
| | |
| Debt supported by Commonwealth appropriations or taxes | 4,038[3] |
| Tax and Revenue Anticipation Notes [4] | 1,200 |
| SUBTOTAL - DEBT PAYABLE FROM GENERAL FUND | $23,804 |
| | |
| Bonds and notes payable from sales and use tax revenues (COFINA) | $15,224 |
| Debt issued by the Commonwealth and its instrumentalities | 24,102[5] |
| Debt issued by municipalities | 4,114 |
| Pension Funding Bonds (payable from employer contributions to ERS) [6] | 2,948 |
| Other limited obligation debt and non-recourse debt [7] | 2,013 |
| SUBTOTAL - OTHER PUBLIC SECTOR DEBT | 48,400 |
| TOTAL PUBLIC SECTOR DEBT | **$72,204** |

Totals may not add due to rounding.

(1) Includes approximately $148.6 million of debt issued by the Treasury Department to GDB which is secured by a pledge of the Commonwealth's good faith and credit and is expected to be repaid with revenues of the Commonwealth or proceeds of a future bond issuance. This debt had been previously included under "Debt issued by the Commonwealth and its instrumentalities." Includes also $28.5 million debt from General Services Administration line of credit.

(2) Consists of $677 million of bonds issued by PRASA, $462 million of Puerto Rico State Revolving Fund loans made to PRASA under various federal water laws, $233.1 million of bonds issued by the POA (which are held by GDB), and $4.138 billion of PBA bonds. Excludes (in order to avoid double counting) $267 million of GDB bonds payable from available moneys of GDB, $110 million of GDB senior guaranteed notes Series 2013B and $900 million of GDB senior guaranteed notes used to purchase the 2015 tax and revenue anticipation notes issued by the Commonwealth.

(3) Represents bonds and notes payable from the Commonwealth General Fund and Public Improvement Fund. Includes $1.090 billion of bonds issued by the Public Finance Corporation, $2.191 billion of appropriation debt notes issued by the instrumentalities and agencies (including $64.7 million of notes issued by PBA), $719.8 million of notes issued by the Treasury Department (such debt is excluded from the Public Corporations Debt Table) and $36.4 million of bonds issued by the Mental Health and Anti-Addiction Services Administration.

(4) Includes $200 million in revolving notes and $1 billion in non-revolving notes purchased by GDB.

(5) Excludes (in order to avoid double counting) $5.9 billion of notes issued by GDB, the proceeds of which have been principally used to fund loans to the Commonwealth, instrumentalities, agencies and municipalities, which loans are included in the table in the corresponding line, and excludes a note for $64.7 million of PBA. Includes $113.0 million in notes issued by PBA.

(6) Represents Senior Pension Funding Bonds, Series A, B, and C issued by the Employees Retirement System, which are payable solely from employer contributions made to the Employees Retirement System by the Commonwealth and its instrumentalities after the issuance of the bonds. The Commonwealth does not guarantee such bonds. Employer contributions made to the Employees Retirement System by the central government and its agencies and therefore payable from the General Fund currently represent approximately 42% of such total employer contributions. The balance of these contributions is made by the instrumentalities and the municipalities.

(7) Includes the following: (i) $1.2 billion of Children's Trust bonds, which are payable solely from the payments to be received pursuant to the tobacco litigation settlement; (ii) $140.5 million of Housing Finance Authority bonds, which are payable from Puerto Rico Housing Administration's annual allocation of Public Housing Capital Funds from the United States Department of Housing and Urban Development ("HUD"); (iii) $295.2 million of Capital Fund Modernization Program Subordinate Bonds, Series 2008 issued by the Puerto Rico Housing Finance Authority and payable primarily from federal housing assistance payments made available by HUD; (iv) $136.1 million of Special Facilities Revenue Bonds issued by the Highways Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge; (v) $155 million of Special Facilities Bonds issued by the Puerto Rico Ports Authority, which are solely payable from the pledge of certain payments made by a private corporation under a special facilities agreement; (vi) $68.7 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA"), which are payable from rent payments made by the University of Puerto Rico; and (vii) approximately $18 million of bonds issued by AFICA to finance the construction of various government infrastructure projects, which are payable from rent payments made by various government entities.

Source: Government Development Bank

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

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

| Fiscal Year Ending June 30 | General Obligation (G.O.) Bonds[1] | PBA Guaranteed Debt | Other Guaranteed Debt[2] | Total G.O. and Guaranteed Debt | Publicly Issued Appropriation Bonds[3] | Total G.O., Guaranteed and Publicly Issued Appropriation Debt |
|---|---|---|---|---|---|---|
| 2015 | 881,248 | 312,919 | 102,699 | 1,296,866 | 38,200 | 1,335,066 |
| 2016 | 1,164,766 | 312,666 | 386,666 | 1,864,098 | 93,656 | 1,957,754 |
| 2017 | 1,164,311 | 312,705 | 123,789 | 1,600,805 | 85,782 | 1,686,586 |
| 2018 | 1,101,062 | 280,763 | 158,925 | 1,540,750 | 85,665 | 1,626,416 |
| 2019 | 1,125,143 | 280,557 | 143,653 | 1,549,352 | 85,552 | 1,634,904 |
| 2020 | 1,152,343 | 281,226 | 148,576 | 1,582,145 | 85,462 | 1,667,607 |
| 2021 | 1,019,554 | 302,468 | 113,504 | 1,435,526 | 85,344 | 1,520,870 |
| 2022 | 1,026,815 | 298,174 | 112,476 | 1,437,465 | 85,220 | 1,522,686 |
| 2023 | 1,026,014 | 286,730 | 111,501 | 1,424,245 | 85,085 | 1,509,330 |
| 2024 | 1,025,214 | 288,448 | 113,672 | 1,427,335 | 84,884 | 1,512,218 |
| 2025 | 1,024,407 | 285,892 | 112,394 | 1,422,693 | 85,205 | 1,507,898 |
| 2026 | 1,023,479 | 272,673 | 110,237 | 1,406,389 | 85,101 | 1,491,490 |
| 2027 | 1,022,683 | 273,518 | 107,352 | 1,403,553 | 84,982 | 1,488,535 |
| 2028 | 1,021,796 | 1,000,141 | 104,558 | 2,126,495 | 223,979 | 2,350,474 |
| 2029 | 1,021,054 | 206,612 | 96,871 | 1,324,538 | 212,727 | 1,537,265 |
| 2030 | 1,020,197 | 362,782 | 93,228 | 1,476,206 | 103,243 | 1,579,449 |
| 2031 | 1,019,403 | 233,648 | 85,724 | 1,338,776 | 103,246 | 1,442,022 |
| 2032 | 1,018,521 | 215,143 | 84,277 | 1,317,941 | 83,409 | 1,401,350 |
| 2033 | 1,017,652 | 215,036 | 80,753 | 1,313,441 | - | 1,313,441 |
| 2034 | 1,016,750 | 214,925 | 78,560 | 1,310,235 | - | 1,310,235 |
| 2035 | 1,015,925 | 228,469 | 39,126 | 1,283,520 | - | 1,283,520 |
| 2036 | 473,691 | 214,808 | 37,468 | 725,968 | - | 725,968 |
| 2037 | 472,859 | 200,521 | 36,174 | 709,554 | - | 709,554 |
| 2038 | 515,192 | 186,389 | 35,075 | 736,655 | - | 736,655 |
| 2039 | 514,358 | 188,509 | 34,099 | 736,967 | - | 736,967 |
| 2040 | 573,523 | 190,220 | 31,668 | 795,410 | - | 795,410 |
| 2041 | 572,687 | 190,218 | 28,906 | 791,811 | - | 791,811 |
| 2042 | 8,681 | 133,552 | 28,024 | 170,257 | - | 170,257 |
| 2043 | 5,733 | - | 26,205 | 31,938 | - | 31,938 |
| 2044 | - | - | 23,972 | 23,972 | - | 23,972 |
| 2045 | - | - | 22,264 | 22,264 | - | 22,264 |
| 2046 | - | - | 12,038 | 12,038 | - | 12,038 |
| 2047 | - | - | 11,133 | 11,133 | - | 11,133 |
| 2048 | - | - | 7,908 | 7,908 | - | 7,908 |
| 2049 | - | - | 6,263 | 6,263 | - | 6,263 |
| 2050 | - | - | 5,671 | 5,671 | - | 5,671 |
| 2051 | - | - | 3,979 | 3,979 | - | 3,979 |
| 2052 | - | - | 2,191 | 2,191 | - | 2,191 |
| 2053 | - | - | 1,104 | 1,104 | - | 1,104 |
| | $25,045,060 | $7,769,713 | $2,862,686 | $35,677,459 | $1,796,740 | $37,474,199 |

(1) General Obligation Bonds debt service is calculated assuming any outstanding Variable Rate GOs (approximately $126.7 million aggregate principal amount outstanding) bear interest at the maximum allowable rate per annum under Puerto Rico law (12%) and includes a $28.5 million General Services Administration line of credit, $113.6 million of unpaid principal only line of credit for fiscal years 2013 and 2014, and $35 million balance of $290 million and $100 million lines of credit. Amounts shown do not include capitalized interest of $160 million for fiscal year 2015 and $75 million for fiscal year 2016.

(2) Includes $677 million of bonds issued by PRASA, $462 million of Puerto Rico State Revolving Fund loans made to PRASA under various federal water laws, $233 million of POA Guaranteed Bonds, $267 million of GDB guaranteed by the Commonwealth and $110 million of GDB senior guaranteed notes Series 2013B. Assumes that the POA Guaranteed Bonds, which are held by GDB and are due on January 1, 2045, are restructured as anticipated to provide for level debt service.

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

## Variable Rate Bonds and Mandatory Tender Bonds

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

After the refunding of certain Commonwealth general obligation variable rate bonds and the termination of certain interest rate exchange agreements from the proceeds of the Series 2014 Bonds, the only outstanding variable rate debt issued by the Commonwealth is approximately $126.7 million principal amount of variable rate general obligation bonds (the interest rate on which is tied to the consumer price index). As of March 31, 2015, the Commonwealth has no outstanding interest rate exchange agreements.

The following table shows the breakdown of variable rate debt of the Commonwealth and the public corporations as of March 31, 2015. This table does not include approximately $696 million in PREPA lines of credit with commercial banks, all of which bear interest at variable rates.

**Variable Rate Debt Breakdown**
(as of March 31, 2015)

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

As of March 31, 2015, PBA had $129,225,000 of fixed rate bonds guaranteed by the Commonwealth that are subject to mandatory tender for purchase on July 1, 2017, prior to their maturity date (the "Mandatory Tender Bonds"). There is no liquidity facility in place for the payment of the purchase price payable upon the mandatory tender, which purchase price is expected to be obtained from the remarketing of the bonds. If PBA cannot remarket the Mandatory Tender Bonds, it would have to obtain other funds in order to provide for the purchase price of these bonds or the bonds would become subject to higher interest rates and an accelerated amortization schedule.

## Interest Rate Exchange Agreements

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

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

The aggregate notional amount of the swaps for the public corporations as of March 31, 2015 was $388.9 million. The table below shows the aggregate notional amount, as of that date, of synthetic fixed rate swaps of the public corporations.

**Swap Portfolio Breakdown**
**Notional Amount**
(as of March 31, 2015)

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

The following table shows, as of March 31, 2015, the net mark-to-market value of all outstanding interest rate exchange agreements. The mark-to-market value of all such agreements of the public corporations was negative as of such date. Thus, the public corporations would owe money to the counterparties if any of the agreements with a negative mark-to-market had been terminated as of that date.

**Swap Portfolio Mark-to-Market Valuation**
(as of March 31, 2015)

| | Synthetic Fixed |
|---|---|
| PREPA | ($60,244,945) |
| COFINA | ($88,041,237) |
| Total | ($148,286,182) |

***Collateral Requirements and Additional Termination Events***. Under its interest rate exchange agreements, PREPA may be required to deliver collateral to the counterparties to guarantee its performance under the agreements, depending on its credit ratings and the credit ratings of insurers, as well as the mark-to-market values. As of March 31, 2015, PREPA was not required to post any collateral. However, if the credit ratings of its swap insurers were to be lowered, PREPA could be required to post collateral on all swaps and certain trades may be subject to termination solely at the option of the applicable counterparty. If any such agreements were to be terminated, they would likely be terminated at their then current mark-to-market valuations, plus cost, which could differ substantially from the mark-to-market valuations set forth in the table above due to market conditions at the time of termination. Any collateral posted at the time of the terminations could be used to effectively offset a like-amount of liquidity needed to fund the termination payments. If any such agreements related to underlying variable rate debt were to be terminated, PREPA would then be subject to variable interest rate risk on the corresponding bonds.

Under its interest rate exchange agreement, COFINA or its swap counterparty may be required to post collateral during each fiscal year depending on the transaction's mark-to-market value. In accordance with these requirements, COFINA had posted collateral of $27 million to its counterparty as of March 31, 2015. The maximum amount COFINA is required to transfer in a given fiscal year is $15 million, with the total posting capped at $60 million. Each year, until the collateral requirement is met, the trustee will deposit up to $15 million from surplus revenues into an account which will be used to satisfy any posting requirements for a given fiscal year.

**Commonwealth Guaranteed Debt**

As of March 31, 2015, $4.138 billion of Commonwealth guaranteed bonds of PBA were outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). Maximum annual debt service on these bonds is $961 million in fiscal year 2028, assuming the receipt of the issuer subsidy from the federal government on the $756,449,000 Government Facilities Revenue Bonds, Series R (Qualified School Construction Bonds – Issuer Subsidy) and the $121,528,000 Government Facilities Revenue Bonds, Series T (Qualified Zone Academy Bonds – Direct Payment), and $1.0 billion in fiscal year 2028 without taking into consideration said subsidy, with their final maturity being July 1, 2042. No payments under the Commonwealth guaranty have been required to date for these bonds.

As of March 31, 2015, $267 million of Commonwealth guaranteed bonds of GDB were outstanding. No payments under the Commonwealth guaranty have been required for these bonds. On October 10, 2014, GDB issued or entered into agreements providing for the issuance of an aggregate of $900 million in notes guaranteed by the Commonwealth maturing on or prior to June 30, 2015, the proceeds of which were used to purchase TRANS issued by the Commonwealth. As of May 1, 2015, $500 million of such TRANS remain outstanding.

As of March 31, 2015, GDB held approximately $233 million of the Port of the Americas Authority's outstanding bonds, which are guaranteed by the Commonwealth. The proceeds from these bonds have been used to refinance and repay the outstanding bonds that were due and payable on January 1, 2015. The aggregate outstanding principal amount of these bonds is payable in full on January 1, 2045. The Commonwealth has been paying debt service on these bonds under its guaranty pursuant to Act No. 409 of September 22, 2004. While the responsibility for the development and operation of the Port of the Americas was transferred from the Port of the Americas Authority to the Ponce Ports Authority in December 2011, the Port of the Americas Authority retained the liability for the outstanding bonds, which are expected to be paid by the Commonwealth under the guarantee to the extent that the revenues and other moneys of the Authority pledged to the payment of such principal and interest are not sufficient to pay the bonds.

As of March 31, 2015, the aggregate outstanding principal amount of obligations of PRASA guaranteed by the Commonwealth was approximately $1.138 billion. This amount consists of $284.8 million of revenue refunding bonds sold to the public, $392.6 million of bonds issued to the United States Department of Agriculture, Rural Development, and loans made by the State Revolving (Clean Water and Safe Drinking Water Act) Funds for the benefit of PRASA with an outstanding principal amount of $459.9 million. See "PUBLIC CORPORATIONS - Puerto Rico Aqueduct and Sewer Authority" in the Base Commonwealth Report.

On March 17, 2015, PRIFA issued approximately $246 million of bond anticipation notes guaranteed by the Commonwealth, and payable from a new petroleum products tax assigned to PRIFA pursuant to Act 1-2015. The proceeds of these notes were used to refinance certain bond anticipation notes issued by the PRHTA.

During fiscal years 2011 and 2012, the Commonwealth made subsidy payments to PRASA for its operational expenses in the amounts of $105 million and $70.2 million, respectively.

**Trends of Public Sector Debt**

The following table shows the growth rate of short-term and long-term public sector debt and the growth rate of gross national product (in current dollars) for the five fiscal years ended June 30, 2014 and as of March 31, 2015. As of March 31, 2015, outstanding short-term debt, relative to total debt, was 8.1%. Total public sector debt for fiscal year 2014 shown in the table below represented 94.0% of nominal gross national product for fiscal year 2014.

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

| | Public Sector Debt | | | | | Gross National Product[1] | |
|---|---|---|---|---|---|---|---|
| June 30, | Long Term[2] | Short Term[3] | Total | Short Term as % of Total | Rate of Increase | Amount | Rate of Increase |
| 2010 | 53,351 | 3,472 | 56,823 | 6.1% | 7.3% | 64,295 | 1.1% |
| 2011 | 54,804 | 4,380 | 59,184 | 7.4% | 4.2% | 65,720 | 2.0% |
| 2012 | 60,780 | 3,981 | 64,760 | 6.2% | 9.5% | 68,698 | 4.5% |
| 2013 | 60,115 | 4,843 | 64,957 | 7.4% | 0.3% | 70,740 | 3.0% |
| 2014 | 62,432 | 4,841 | 67,273 | 7.2% | 3.6% | 72,821 | 3.0% |
| 03/31/2015 | 61,833 | 5,411 | 67,244 | 8.1% | -0.04% | N/A | N/A |

Totals may not add due to rounding.

(1) In current dollars.

(2) Does not include debt identified in footnotes 6 and 7 of the table above entitled "Commonwealth of Puerto Rico—Public Sector Debt," which would have been issued and outstanding at the time, all of which would be considered long-term debt.

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

*Source:* Government Development Bank

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 2014, and as of March 31, 2015.

**Commonwealth of Puerto Rico**
**Public Sector Debt by Major Category**
**(dollars in millions)**

| | Commonwealth(1) | | | Municipalities | | | Public Corporation(2) | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| June 30 | Long Term | Short Term(3) | Total | Long Term | Short Term(3) | Total | Long Term | Short Term(3) | Total | Long Term | Short Term(3) | Total |
| 2009 | $9,382 | $557 | $9,939 | $2,691 | $306 | $2,997 | $36,259 | $3,785 | $40,044 | $48,332 | $4,648 | $52,980 |
| 2010 | 10,033 | 270 | 10,303 | 2,905 | 326 | 3,231 | 40,413 | 2,876 | 43,289 | 53,351 | 3,472 | 56,823 |
| 2011 | 10,199 | 164 | 10,363 | 3,204 | 333 | 3,537 | 41,401 | 3,883 | 45,284 | 54,804 | 4,380 | 59,184 |
| 2012 | 11,578 | 266 | 11,844 | 3,515 | 357 | 3,872 | 45,687 | 3,358 | 49,045 | 60,780 | 3,981 | 64,760 |
| 2013 | 11,838 | 491 | 12,329 | 3,501 | 381 | 3,882 | 44,776 | 3,970 | 48,746 | 60,115 | 4,843 | 64,957 |
| 2014 | 13,932 | 404 | 14,336 | 3,589 | 604 | 4,193 | 44,910 | 3,834 | 48,744 | 62,432 | 4,841 | 67,273 |
| 03/31/15 | 13,654 | 1,396 | 15,050 | 3,500 | 614 | 4,114 | 44,678 | 3,401 | 48,079 | 61,833 | 5,411 | 67,244 |

Totals may not add due to rounding.

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

(2) Includes Commonwealth guaranteed debt; does not include the bonds identified in footnote 7 of the table above entitled "Commonwealth of Puerto Rico – Public Sector Debt."

(3) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt. The amount as of March 31, 2015 includes Tax and Revenue Anticipation Notes outstanding as of such date.

*Source*: Government Development Bank

## Debt of the Public Corporations

The following table presents the outstanding bonds and notes of certain of the public corporations as of March 31, 2015 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Bonds and notes listed under the columns labeled "With Guaranty" are guaranteed by the Commonwealth. Debt of certain other public corporations is excluded from this table because such debt is payable primarily from funds or grants provided by the federal government, sources other than Commonwealth appropriations or taxes or revenues of public corporations, or from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations, such as GDB, the inclusion of which would reflect double counting. No deductions have been made in the table for amounts on deposit in debt service funds and debt service reserve funds.

# Commonwealth of Puerto Rico
# Outstanding Debt of Public Corporations
# March 31, 2015
# (in thousands)

| | Bonds | | | Notes | | | Total Bonds and Notes | | |
|---|---|---|---|---|---|---|---|---|---|
| | With Guaranty | Without Guaranty | Total | With Guaranty | Without Guaranty | Total | With Guaranty | Without Guaranty | Total |
| Aqueduct and Sewer Authority | $677,360 | $3,364,565 | $4,041,925 | $462,176 | $274,507 | $736,683 | $1,139,536 | $3,639,072 | $4,778,608 |
| Convention Center District Authority | - | 408,530 | 408,530 | - | 145,285 | 145,285 | - | 553,815 | 553,815 |
| Electric Power Authority | - | 8,322,405 | 8,322,405 | - | 731,838 | 731,838 | - | 9,054,243 | 9,054,243 |
| Highways and Transportation Authority | - | 4,717,127[1] | 4,717,127 | - | 1,812,981 | 1,812,981 | - | 6,530,108 | 6,530,108 |
| Housing Finance Authority | - | 92,823[2] | 92,823 | - | 169,944 | 169,944 | - | 262,767 | 262,767 |
| Industrial Development Company | - | 175,490 | 175,490 | - | 86,325 | 86,325 | - | 261,815 | 261,815 |
| Infrastructure Financing Authority[3] | - | 1,889,303 | 1,889,303 | - | 295,042 | 295,042 | - | 2,184,345 | 2,184,345 |
| Port of the Americas Authority | 233,056 | - | 233,056 | - | 1,700 | 1,700 | 233,056 | 1,700 | 234,756 |
| Ports Authority[4] | - | - | - | - | 275,222 | 275,222 | - | 275,222 | 275,222 |
| Public Buildings Authority | 4,138,264 | - | 4,138,264 | - | 177,724 | 177,724 | 4,138,264 | 177,724 | 4,315,988 |
| Public Finance Corporation | - | 1,090,740[5] | 1,090,740 | - | - | - | - | 1,090,740 | 1,090,740 |
| Sales Taxes Financing Corp. (COFINA) | - | 15,223,821 | 15,223,821 | - | | | - | 15,223,821 | 15,223,821 |
| University of Puerto Rico | - | 470,775[6] | 470,775 | - | 85,186 | 85,186 | - | 555,961 | 555,961 |
| Others[7] | - | - | - | - | 2,757,170 | 2,757,170 | - | 2,757,170 | 2,757,170 |
| Total[8] | $5,048,680 | $35,755,579 | $40,804,259 | $462,176 | $6,812,924 | $7,275,100 | $5,510,856 | $42,568,503 | $48,079,359 |

(1) Excludes $136.1 million of Special Facilities Revenue Bonds issued by PRHTA, which are payable by a private party from net toll revenues collected from the Teodoro Moscoso Bridge.

(2) Excludes the $140.5 million of Housing Finance Authority bonds, which are payable solely from Puerto Rico Public Housing Administration's annual allocation of Public Housing Capital Funds from HUD; and $295.2 million of Housing Finance Authority Capital Fund Modernization Program Subordinate Bonds, Series 2008 issued by the Housing Finance Authority and payable primarily from federal housing assistance payments made available by HUD.

(3) Includes (i) $36.4 million of Mental Health Infrastructure Revenue Bonds, 2007 Series A (MEPSI Campus Project), which bonds are limited obligations of the Infrastructure Financing Authority payable solely from the pledge of certain payments made by a governmental entity under a lease agreement and (ii) $192.3 million of Revenue Bonds (Ports Authority Project), Series 2011, which are limited obligations of the Infrastructure Financing Authority payable solely from loan payments made by the Puerto Rico Ports Authority.

(4) Excludes $155.4 million of Special Facilities Revenues Bonds issued by the Puerto Rico Ports Authority, which bonds are payable solely from the pledge of certain payments made by a private corporation under a special facilities agreement.

(5) Payable primarily from Commonwealth appropriations.

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

(7) Includes lines of credit from GDB and private banks.

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

*Source:* Government Development Bank

## LITIGATION

The following section provides an update to the information set forth under LITIGATION in the Base Commonwealth Report. Information is provided with respect to individual cases where the potential exposure has been estimated at more than $50 million.

With respect to pending and threatened litigation (6,264 cases), excluding the cases mentioned under LITIGATION, as of March 31, 2015 the Commonwealth has included in its financial statements reported liabilities of approximately $1.7 billion for awarded and anticipated unfavorable judgments. Such amount represents the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. The amounts claimed as of February 28, 2015 exceed $9.9 billion; however, the ultimate specific liability cannot be presently determined, especially because of the nature of labor claims, where the awards for unpaid salaries are calculated by the agencies. The Commonwealth believes that most of the claims are excessive, frivolous, or both, and that its ultimate liability should not significantly exceed the amounts set forth in the Commonwealth's financial statements.

### Act for the Redistribution and Adjustment of the Tax Reform

The Puerto Rico Marketing, Industry and Food Distribution Chamber ("MIDA") did not file a motion for reconsideration of the Supreme Court's decision to deny MIDA's petition for certiorari. Therefore, the trial court's dismissal of MIDA's lawsuit is now final.

### Doral Financial Corporation Litigation

On February 25, 2015, the Court of Appeals reversed the trial court's judgment, and ruled that the closing agreement between the Treasury Department and Doral was null and void. The Puerto Rico Supreme Court declined to review the decision, which is now final and favorable to the Commonwealth.

### Puerto Rico Debt Enforcement and Recovery Act

On February 6, 2015, the United States District Court issued a declaratory judgment and permanent injunction holding that the Recovery Act is unconstitutional because it is preempted by the United States Bankruptcy Code. The Commonwealth filed an expedited appeal before the United States Court of Appeals for the First Circuit. The parties have filed their briefs and oral arguments were held on May 6, 2015.

### Special Education Students

On November 13, 2014 the court increased the fines for failure to comply with the court's order to $10,000 per day. Also, the court established a special fine of $300,000 to be used for the benefit of the members of the class. The Department of Education has appealed this decision.

**Police Institutional Reform**

The Commonwealth recently increased its estimate of the investment that will be required to comply with the court ordered institutional reform from $200 million to $600 million. The reform is to be implemented within the next ten years.

**Wage Claims**

On August 7, 2014, the trial court dismissed one of the two lawsuits. The Plaintiffs have appealed the decision.

**Employees Retirement System Bond Issuance**

Plaintiffs are pensioners of the Employees Retirement System. They filed the claim on behalf of the ERS against the underwriters of certain ERS pension bonds and some of the former members of the Board of Trustees of the ERS. The complaint requested $800 million in damages resulting from the $3 billion bond issuance in 2008 that according to the plaintiffs compromised the solvency of the ERS. The case is in its early stage.

**Police Association Wage Claims**

Four police organizations and their members and forty-one agents in a separate lawsuit claim back pay wages under laws that mandated salary increases for the Puerto Rico Police Department ("PRPD") members, among other governmental employees. All cases are in discovery process and pending status and pre-trial conference. The potential exposure of the PRPD is approximately $270 million.

**Federal Clean Water Act Complaint from the Environmental Protection Agency**

The United States Department of Justice ("USDOJ"), acting on behalf of the United States Environmental Protection Agency ("EPA"), has filed a complaint alleging unauthorized discharges of pollutants from the storm sewer systems owned and/or operated by the Municipality of San Juan ("MSJ"), the Department of Transportation and Public Works ("DTPW") and the Puerto Rico Highways and Transportation Authority ("PRHTA") through certain flood control pump stations owned and operated by the Department of Natural and Environmental Resources ("DNER"), into the waters of the United States, in violation of the Federal Clean Water Act. The Complaint seeks the assessment of civil penalties against MSJ, DTPW/PRHTA, DNER and the Commonwealth of Puerto Rico for past and present violations of up to $32,500.00 per day per violation, for those violations that occurred between February 5, 2007 and January 12, 2009; and $37,500.00 per day per violation, for those violations that occurred from January 13, 2009 to the present. The complaint further seeks injunctive relief to bring the defendants into compliance with the Municipal Separate Storm Sewer Systems Permit. MSJ, DNER, and DTPW/PRHTA are currently individually engaged in settlement negotiations with USDOJ/EPA to resolve the matter by entering into separate Consent Decrees to be filed with the U.S. District Court for the District of Puerto Rico. Ongoing settlement negotiations entail discussing the terms and conditions to be incorporated into such Consent Decrees. However, USDOJ/EPA have not yet made a monetary civil penalty proposal to any of the defendants. Thus, it is not yet possible at this time to accurately assess the monetary exposure of the defendants.