$546,150,000
University of Puerto Rico
$286,505,000 University System Revenue Refunding Bonds, Series P
$259,645,000 University System Revenue Bonds, Series Q

The University System Revenue Refunding Bonds, Series P (the "2006 Refunding Bonds") and the University System Revenue Bonds, Series Q (the "2006 Series Q Bonds," and together with the 2006 Refunding Bonds, the "2006 Bonds"), are being issued pursuant to the terms of the Trust Agreement described herein.

The 2006 Bonds, any other outstanding bonds of the University of Puerto Rico (the "University") previously issued under the Trust Agreement and any additional bonds (collectively, the "Bonds") that the University may from time to time issue under the Trust Agreement are general obligations of the University payable from any monies available to the University. The principal of and interest on the Bonds are secured by a pledge of the Pledged Revenues of the University, as described in the Trust Agreement and in this Official Statement. See "SECURITY AND SOURCES OF PAYMENT FOR THE BONDS," beginning on page 7 of this Official Statement for a description of the Pledged Revenues.

The 2006 Bonds will have the following characteristics:

- The 2006 Bonds will be dated December 13, 2006.
- The 2006 Bonds will be registered under The Depository Trust Company's book-entry only system. Purchasers of the 2006 Bonds will not receive definitive 2006 Bonds.
- The 2006 Bonds are subject to redemption by the University as described in this Official Statement, the earliest possible date of redemption being June 1, 2016.
- Interest on the 2006 Bonds will be payable on June 1, 2007 and on each December 1 and June 1 thereafter.
- Subject to continuing compliance with certain tax covenants, interest on the 2006 Bonds will not be includable in gross income for federal income tax purposes and interest on the 2006 Bonds is exempt from state, Commonwealth and local income taxation under existing law. However, see TAX MATTERS, beginning on page 53 of this Official Statement, for alternative minimum tax consequences with respect to interest on the 2006 Bonds and other tax considerations.
- It is expected that settlement for the 2006 Bonds will occur on or about December 13, 2006.

The inside cover page contains information concerning the maturity schedules, interest rates and prices or yields on the 2006 Bonds.

The 2006 Bonds are not a debt or obligation of the Commonwealth of Puerto Rico (the "Commonwealth") or any municipality or other political subdivision of the Commonwealth, other than the University, and neither the Commonwealth nor any municipality or other political subdivision of the Commonwealth, other than the University, shall be liable therefor. The good faith and credit of the Commonwealth or that of any municipality or other political subdivision of the Commonwealth, other than the University, are not pledged for the payment of the 2006 Bonds.

Lehman Brothers	**Merrill Lynch & Co.**	**Samuel A. Ramirez & Co.**
Banc of America Securities LLC	**Citigroup**	**Goldman, Sachs & Co.**
JPMorgan	**Morgan Stanley**	**Popular Securities**
Raymond James & Associates, Inc.	**UBS Investment Bank**	**Wachovia Bank, National Association**

November 30, 2006

$286,505,000
University System Revenue Refunding Bonds, Series P
$238,860,000 Serial Bonds

Year (June 1)	Principal Amount	Interest Rate	Yield	CUSIP	Year (June 1)	Principal Amount	Interest Rate	Yield	CUSIP
2010	$4,005,000	5.00%	3.78%	914811NB6	2019	$15,990,000	5.00%	4.05%*	914811NL4
2011	5,760,000	5.00	3.80	914811NC4	2020	16,790,000	5.00	4.08*	914811NM2
2012	7,230,000	5.00	3.81	914811ND2	2021	17,625,000	5.00	4.11*	914811NN0
2013	11,930,000	5.00	3.82	914811NE0	2022	18,510,000	5.00	4.13*	914811NP5
2014	12,525,000	5.00	3.85	914811NF7	2023	19,435,000	5.00	4.15*	914811NQ3
2015	13,155,000	5.00	3.89	914811NG5	2024	20,410,000	5.00	4.17*	914811NR1
2016	13,815,000	5.00	3.93	914811NH3	2025	21,425,000	5.00	4.19*	914811NS9
2017	14,500,000	5.00	3.97*	914811NJ9	2026	10,530,000	5.00	4.21*	914811NT7
2018	15,225,000	5.00	4.01*	914811NK6					

$47,645,000 Term Bonds 5.00% due June 1, 2030 - Yield 4.23%* - CUSIP 914811NU4

$259,645,000
University System Revenue Bonds, Series Q
$127,230,000 Serial Bonds

Year (June 1)	Principal Amount	Interest Rate	Yield	CUSIP	Year (June 1)	Principal Amount	Interest Rate	Yield	CUSIP
2008	$4,165,000	5.00%	3.72%	914811NV2	2018	6,785,000	5.00%	4.01%*	914811PF5
2009	4,375,000	5.00	3.75	914811NW0	2019	7,125,000	5.00	4.05*	914811PG3
2010	4,595,000	5.00	3.78	914811NX8	2020	7,480,000	5.00	4.08*	914811PH1
2011	4,825,000	5.00	3.80	914811NY6	2021	7,855,000	5.00	4.11*	914811PJ7
2012	5,065,000	5.00	3.81	914811NZ3	2022	8,250,000	5.00	4.13*	914811PK4
2013	5,315,000	5.00	3.82	914811PA6	2023	8,660,000	5.00	4.15*	914811PL2
2014	5,585,000	5.00	3.85	914811PB4	2024	9,095,000	5.00	4.17*	914811PM0
2015	5,860,000	5.00	3.89	914811PC2	2025	9,550,000	5.00	4.19*	914811PN8
2016	6,155,000	5.00	3.93	914811PD0	2026	10,025,000	5.00	4.21*	914811PP3
2017	6,465,000	5.00	3.97*	914811PE8					

$45,375,000 Term Bonds 5.00% due June 1, 2030 - Yield 4.23%* - CUSIP 914811PQ1
$87,040,000 Term Bonds 5.00% due June 1, 2036 - Yield 4.27%* - CUSIP 914811PR9

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* Priced to June 1, 2016 call date.

The information set forth in this Official Statement has been obtained from the University and other official sources that are believed to be reliable. The information set forth herein with respect to The Depository Trust Company ("DTC") has been obtained from the DTC. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs or condition of the University or the Commonwealth since the date hereof. The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information. No dealer, broker, sales representative or other person has been authorized by the University or the Underwriters to give any information or to make any representations other than those contained or incorporated by reference in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by the University or any Underwriter. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the 2006 Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale.

THE UNDERWRITERS HAVE ALSO PROVIDED THE FOLLOWING FOR INCLUSION IN THIS OFFICIAL STATEMENT. IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE 2006 BONDS AND THE OTHER OUTSTANDING BONDS OF THE UNIVERSITY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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INTRODUCTION

This Official Statement, which includes the cover page and the appendices hereto, sets forth information in connection with the sale by the University of Puerto Rico (the "University"), an independent public corporation, of $546,150,000 aggregate principal amount of its $286,505,000 University System Revenue Refunding Bonds, Series P (the "2006 Refunding Bonds") and the $259,645,000 University System Revenue Bonds, Series Q (the "2006 Series Q Bonds," and together with the 2006 Refunding Bonds, the "2006 Bonds"). The 2006 Bonds will be issued under and secured by a Trust Agreement, dated as of June 1, 1971, as amended (the "Trust Agreement"), among the University, U.S. Bank Trust National Association, successor trustee (the "Trustee"), and Banco Popular de Puerto Rico, co-trustee (the "Co-Trustee"). The 2006 Bonds, the outstanding bonds heretofore issued under the Trust Agreement and any additional bonds hereafter issued under the Trust Agreement are collectively called the "Bonds."

All Bonds will be secured equally and ratably under the Trust Agreement and will be payable from Pledged Revenues (as defined below). The University has heretofore issued Bonds pursuant to the Trust Agreement, of which $373,652,825 principal amount was outstanding as of November 30, 2006.

This Official Statement also includes (i) the Commonwealth of Puerto Rico Financial Information and Operating Data Report dated as of July 1, 2006 (the "Commonwealth Report"), which is incorporated herein by this reference, (ii) the Audited Financial Statements for the University of Puerto Rico for the year ended June 30, 2005, attached as Appendix A; (iii) the proposed form of Bond counsel opinion, attached hereto as Appendix B, and (iv) the Comprehensive Annual Financial Report of the Commonwealth for the fiscal year ended June 30, 2005, prepared by the Department of the Treasury of the Commonwealth (the "Commonwealth's Annual Financial Report"), which is incorporated herein by this reference. The Commonwealth's Annual Financial Report includes the basic financial statements of the Commonwealth for the fiscal year ended June 30, 2005, together with the independent auditor's report thereon dated March 14, 2006, of KPMG LLP, certified public accountants (the "Commonwealth Financial Statements"). KPMG LLP did not audit the financial statements of the Public Buildings Authority capital project fund (a major fund), and certain activities, funds and component units separately identified in their report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and their opinion on the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, is based solely on the reports of the other auditors. The report by KPMG LLP contains an emphasis paragraph for the adoption of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposits and Investment Risk Disclosures*, as of June 30, 2005.

The Commonwealth Report includes important information about the Commonwealth, including information about its economy, historical revenues and expenditures of the Commonwealth's General Fund, the year-end results for the fiscal year 2006 budget, the fiscal year 2007 budget, and the debt of the Commonwealth's public sector, and should be read in its entirety. The Commonwealth's Annual Financial Report was filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR") as Appendix I to the Official Statement for the offering of the Commonwealth's Public Improvement Bonds, Series 2006 A and Public Improvement Refunding Bonds, Series 2006 B both issued on August 2, 2006.

Any appendix of an Official Statement of the Commonwealth or of any instrumentality of the Commonwealth containing any revision to the Commonwealth Report, or to the Commonwealth's Annual Financial Report that is filed with each NRMSIR and the Municipal Securities Rule Making Board ("MSRB"), or any new or revised Commonwealth Report or Commonwealth Annual Financial Report, or other document containing information that modifies or supersedes the information contained in the Commonwealth Report or in the Commonwealth's Annual Financial Report that is filed with each NRMSIR, in each case after the date hereof and prior to the termination of the offering of the 2006 Bonds, shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained in the Commonwealth's Annual Financial

Report or in the Commonwealth Report shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any such subsequently filed document modifies or supersedes such statement.

This Official Statement, including information incorporated in this Official Statement by reference, contains certain "forward-looking statements" concerning the Commonwealth's operations and financial condition. These statements are based upon a number of assumptions and estimates which are subject to significant uncertainties, many of which are beyond the control of the Commonwealth. The words "may," "would," "could," "will," "expect," "anticipate," "believe," "intend," "plan," "estimate" and similar expressions are meant to identify these forward-looking statements. Actual results may differ materially from those expressed or implied by these forward-looking statements. Capitalized terms used in this Official Statement and not otherwise defined herein shall have the meanings given to them in the Trust Agreement.

PLAN OF FINANCING

The University is issuing the 2006 Refunding Bonds to refund a portion of its University System Revenue Bonds, Series M and Series O in the amounts and maturities, at the redemption prices and on the maturity or redemption dates identified in the table below and pay costs of issuing the 2006 Refunding Bonds.

SERIES M

Maturity Date June 1,	Principal Amount to be Refunded	Interest Rate	Redemption Price	Redemption Date
2007	$4,450,000	5.30%	100.75%	March 12, 2007
2008	4,685,000	5.40	100.75	March 12, 2007
2015	35,865,000	5.50	100.75	March 12, 2007
2025	91,350,000	5.25	100.75	March 12, 2007

SERIES O

Maturity Date June 1,	Principal Amount to be Refunded	Interest Rate	Redemption Price	Redemption Date
2009	$4,340,000	4.50%	N/A	N/A
2010	4,535,000	4.60	N/A	N/A
2012	2,655,000	5.75	100%	June 1, 2010
2013	2,560,000	4.90	100	June 1, 2010
2013	2,670,000	5.75	100	June 1, 2010
2014	5,510,000	5.00	100	June 1, 2010
2015	5,785,000	5.125	100	June 1, 2010
2016	2,940,000	5.75	100	June 1, 2010
2016	3,145,000	5.20	100	June 1, 2010
2017	2,700,000	5.25	100	June 1, 2010
2017	3,715,000	5.75	100	June 1, 2010

2018	1,800,000	5.30	100	June 1, 2010
2018	4,970,000	5.75	100	June 1, 2010
2019	2,210,000	5.35	100	June 1, 2010
2019	4,940,000	5.75	100	June 1, 2010
2020	7,555,000	5.375	100	June 1, 2010
2030	101,905,000	5.375	100	January 12, 2007

The refunding will permit the University to realize present value savings on its debt service requirements under the Trust Agreement. The University will deposit the net proceeds of the 2006 Refunding Bonds, together with certain other available monies, with the Trustee, as escrow agent, in a special redemption fund under the terms of the Escrow Deposit Agreement. Such net proceeds, together with such other available monies, will be invested in Government Obligations the principal of and interest on which when due, together with any monies deposited with the Trustee remaining uninvested, will provide monies sufficient to pay the principal of and redemption premium and interest on the Refunded Bonds on the respective dates of maturity and redemption and the interest to accrue on such Bonds through such dates.

Upon the deposit with the Trustee referred to above, in the opinion of Bond Counsel, the Refunded Bonds will no longer be outstanding under the provisions of the Trust Agreement.

The University is issuing the 2006 Series Q Bonds (i) to finance a portion of the costs of various projects included in the University's current Capital Improvements Program, (ii) to refinance $82,583,296.09 aggregate principal amount of notes held by Government Development Bank issued to finance such costs initially, and (iii) to pay costs of issuing the 2006 Bonds.

Sources and Uses of Funds

2006 Bonds

Sources:		
	2006 Refunding Bonds	$ 286,505,000.00
	2006 Series Q Bonds	259,645,000.00
	Net Discount / Premium	35,261,688.95
	Bond Service Account Transfer	1,642,113.27
	Total	$ 583,053,802.22
Uses:		
	Deposit into Escrow for Refunded Bonds	305,288,872.40
	Repayment of Government Development Bank Line of Credit	82,583,296.09
	Deposit to Construction Fund	168,271,793.46
	Deposit to Reserve Account	16,589,826.87
	Deposit to Capitalized Interest Fund	6,058,383.33
	Underwriting Discount, Legal, Printing and other Issuing Expenses	4,261,630.07
	Total	$ 583,053,802.22

THE 2006 BONDS

Description

The 2006 Bonds will be dated December 13, 2006, will bear interest at such rates, will be payable at such times, and will mature on the dates and in the principal amounts set forth on the inside cover page of this Official Statement. The 2006 Bonds are subject to redemption as described below under "Redemption Provisions."

Redemption Provisions

Optional Redemption. The 2006 Bonds maturing after June 1, 2016, may be redeemed at the option of the University prior to maturity, upon not less than 30 days prior notice by mail, from any available monies (other than monies set aside in the Sinking Fund in respect of an Amortization Requirement), either in whole or in part, on any date not earlier than June 1, 2016 at a redemption price equal to the outstanding principal amount of such 2006 Bonds to be redeemed plus accrued interest to the redemption date, without premium.

Subject to the provisions of the Trust Agreement, if more than one maturity of 2006 Bonds is subject to redemption in part, the 2006 Bonds shall be called for redemption in such order as the University shall direct.

Amortization Requirements. The 2006 Bonds maturing on June 1, 2030, shall be redeemed in part on June 1, 2027 and on each June 1 thereafter until June 1, 2029, and the 2006 Bonds maturing on June 1, 2036, shall be redeemed in part on June 1, 2031 and on each June 1 thereafter until June 1, 2035, in each case, in the principal amounts equal to the respective Amortization Requirements for said 2006 Bonds (less the principal amount of any 2006 Bonds retired by purchase) from monies in the Sinking Fund at 100% of the principal amount thereof plus accrued interest in the years and amounts set forth below:

Fiscal Year Ending June 30,	Amortization Requirements for 2006 Refunding Bonds due June 1, 2030
2027	$11,055,000
2028	11,605,000
2029	12,185,000
2030	12,800,000*
Total	$47,645,000
Average life (years)	22.03

* Maturity

Fiscal Year Ending June 30,	Amortization Requirements for 2006 Series Q Bonds due June 1, 2030
2027	$10,530,000
2028	11,055,000
2029	11,605,000
2030	12,185,000*
Total	$45,375,000
Average life (years)	22.03

* Maturity

Fiscal Year Ending June 30,	Amortization Requirements for 2006 Series Q Bonds due June 1, 2036
2031	$12,795,000
2032	13,435,000
2033	14,110,000
2034	14,815,000
2035	15,555,000
2036	16,330,000*
Total	$87,040,000
Average life (years)	27.11

* Maturity

Book-Entry Only System

The information in this section concerning The Depository Trust Company, New York, NY ("DTC") and DTC's book-entry system has been obtained from sources that the University and the Underwriters believe to be reliable, but the University and the Underwriters take no responsibility for the accuracy thereof.

DTC will act as securities depository for the 2006 Bonds. The 2006 Bonds will be issued as fully-registered bonds registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for each issue of the 2006 Bonds, each in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds $500 million, one certificate will be issued with respect to each $500 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such issue.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instrument from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of 2006 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2006 Bonds on DTC's records. The ownership interest of each actual purchaser of each Security ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 2006 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in 2006 Bonds, except in the event that use of the book-entry system for the 2006 Bonds is discontinued.

To facilitate subsequent transfers, all 2006 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of 2006 Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2006 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2006 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of 2006 Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the 2006 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the security documents. For example, Beneficial Owners of 2006 Bonds may wish to ascertain that the nominee holding the 2006 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the 2006 Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the 2006 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC will mail an Omnibus Proxy to the University as soon as possible after the applicable record date. The Omnibus Proxy will assign Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the 2006 Bonds are credited on such record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on, including, redemption proceeds, if any, of the 2006 Bonds, will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the University or the Trustee on a payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the Trustee, or the University, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds and other distributions to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the University or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the 2006 Bonds at any time by giving reasonable notice to the University or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, definitive 2006 Bonds are required to be printed and delivered.

The University may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event also, definitive 2006 Bonds will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the University believes to be reliable, but the University takes no responsibility for the accuracy thereof.

Payments and Transfers

No assurance can be given by the University that DTC will make prompt transfer of payments to the Direct Participants or that Direct Participants will make prompt transfer of payments to Indirect Participants or to Beneficial Owners. The University is not responsible or liable for payment by DTC or Participants or for sending transaction statements or for maintaining, supervising or reviewing records maintained by DTC or Participants.

The Trustee and the University will have no responsibility or obligation to any Participants or the persons for whom they act as nominees with respect to the payments to or the providing of notice for the Participants or the Beneficial Owners. Payments made to DTC or its nominee shall satisfy the obligations of the University to the extent of such payments.

For every transfer of the 2006 Bonds, the Beneficial Owner may be charged a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto.

Discontinuance of Book-Entry Only System

In the event that such book-entry only system is discontinued for the 2006 Bonds, the following provisions will apply to the 2006 Bonds: principal of the 2006 Bonds and redemption premium, if any, thereon will be payable in lawful money of the United States of America at the principal corporate trust office of the Trustee in New York, New York. Interest on the 2006 Bonds will be payable on each June I and December 1, by check mailed to the respective addresses of the registered owners thereof as shown on the registration books of the University maintained by the Trustee as of the close of business on the record date therefor (May 15 and November 15, respectively). The 2006 Bonds will be issued only as registered bonds without coupons in authorized denominations. The transfer of the 2006 Bonds will be registrable and the 2006 Bonds may be exchanged at the principal corporate trust office of the Trustee in New York, New York upon the payment of any taxes or other governmental charges required to be paid with respect to such registration of transfer or exchange.

SECURITY AND SOURCES OF PAYMENT FOR THE BONDS

Sources of Payment

The Trust Agreement provides that the Bonds (including the 2006 Bonds) are general obligations of the University and are equally and ratably secured by the pledge of the Pledged Revenues, defined in the Trust Agreement to include the proceeds, receipts, profits and other income derived or to be derived by or on behalf of the University from:

(1) tuition fees;

(2) student fees;

(3) rentals and other charges for the right of use or occupancy of the facilities of the University of a capital nature financed by bonds issued under the Trust Agreement or included in the University's Capital Improvements Program (the "University System") created under the Trust Agreement;

(4) net bookstore receipts;

(5) interest on investment of University funds, excluding the Construction Fund and the Sinking Fund;

(6) funds paid to the University in respect of overhead allowances on federal research projects;

(7) all other income excluding appropriations and contributions; and

(8) amounts received through the debt service grant programs of the United States Government or any agency thereof.

In the event that the Pledged Revenues are insufficient to pay the principal of and the interest on the Bonds, the University has covenanted in the Trust Agreement to provide any required monies from other funds available to the University for such purpose, including funds appropriated by the Commonwealth of Puerto Rico. Under Act No. 2 of January 20, 1966, as amended ("Act No. 2 of 1966"), the University receives in each fiscal year an amount equal to 9.6% of the average total amount of annual revenues collected under the laws of Puerto Rico and accruing to the Commonwealth General Fund in the two immediately preceding fiscal years. See "COMMONWEALTH SUPPORT OF THE UNIVERSITY," below.

The Bonds are not a debt or obligation of the Commonwealth or any municipality or other political subdivision of the Commonwealth, other than the University, and neither the Commonwealth nor any municipality or other subdivision of the Commonwealth, other than the University, shall be liable therefor. The good faith and credit of the Commonwealth or that of any municipality or other political subdivision of the Commonwealth, other than the University, are not pledged for the payment of the Bonds.

Covenant as to Fees and Charges

In the Trust Agreement, the University covenants to fix, impose, revise from time to time, and collect tuition fees, student fees and rentals and other charges for the right of use or occupancy of the facilities in the University System, so that the Pledged Revenues (after deducting any federal debt service grant payments), together with any other funds, including funds appropriated by the Commonwealth of Puerto Rico, will be sufficient to pay principal of and interest on the Bonds (including the 2006 Bonds) and to make the deposits required to be made to the Bond Service Account, the Redemption Account and the Reserve Account.

Reserve Account

Pursuant to the Trust Agreement, a Reserve Account is created in the Sinking Fund for the payment of principal of and interest on all outstanding Bonds whenever monies in the Bond Service Account or the Redemption Account are insufficient for such purpose. The University covenants to accumulate (during a period ending not later than five years after the issuance of the latest series of Bonds) and maintain in the Reserve Account, as provided in the Trust Agreement, an amount equal to the maximum annual aggregate Principal and Interest Requirements on account of all outstanding Bonds (defined in the Trust Agreement as the amount required in each fiscal year to pay interest on and principal, including Amortization Requirements, of the Bonds less payments under any debt service grant program of the United States Government or any agency thereof).

The amount on deposit in the Reserve Account as of November 30, 2006 was $38,646,673.13, which exceeded the amount required by the Trust Agreement. Upon the issuance of the 2006 Bonds, the maximum annual aggregate Principal and Interest Requirements will be $55,236,500. The difference will be deposited by the University simultaneously with the issuance of the 2006 Bonds. See "SUMMARY OF CERTAIN PROVISIONS OF THE TRUST AGREEMENT - Application of Revenues," below.

Additional Bonds

Additional Bonds may be issued under the Trust Agreement, under the conditions and limitations therein set forth, to finance the acquisition and construction of facilities for the University, including the repayment of monies advanced therefor. Such additional Bonds may be issued upon a showing that the lesser of (i) the Pledged Revenues (excluding any monies received in such period under debt service grant programs of the United States Government or any agency thereof) and Reserve Account earnings for twelve consecutive months out of the eighteen months preceding the issuance of such additional Bonds and (ii) the estimated Pledged Revenues (excluding monies expected to be received in such period under such debt service grant programs) and Reserve Account earnings for the twelve months following the issuance of such additional Bonds are not less than 150% of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of the Bonds then outstanding and the additional Bonds then to be issued. Refunding bonds may also be issued under the Trust Agreement for the purpose of refunding at or prior to their respective maturities all or part of the Bonds issued under the Trust Agreement (or to refund bonds not issued under the Trust Agreement).

Subordinated Obligations

In 2000, the University executed a master trust indenture (the "Subordinated Trust Indenture") pursuant to which the University may issue obligations ("Subordinated Obligations") from time to time that will be secured by a pledge of the Pledged Revenues that is subordinate to the pledge of the Trust Agreement. The University anticipates that Subordinated Obligations may be issued under the Subordinated Trust Indenture to finance the acquisition, development, construction and equipping of facilities to be owned, leased, operated or otherwise used by the University, its employees, faculty or students. Under the Subordinated Trust Indenture, Subordinated Obligations may be issued upon a showing that the lesser of (i) the Pledged Revenues (excluding any monies received in such period under debt service grant programs of the United States Government or any agency thereof) for any period of twelve consecutive months within the eighteen calendar months preceding the issuance of such Subordinated Obligations and (ii) the estimated Pledged Revenues (excluding monies expected to be received in such period under such debt service grant programs) for the period of twelve consecutive months beginning with the month in which such Subordinated Obligations are issued are not less than 125% of the maximum scheduled annual debt service for any fiscal year thereafter on account of the Bonds and Subordinated Obligations, if any, then outstanding and the additional Subordinated Obligations then to be issued. The University currently has $ 82,665,000 Subordinated Obligations outstanding under the Subordinated Trust Indenture incurred in respect of the building of Plaza Universitaria. See "DEBT," below.

UNIVERSITY OF PUERTO RICO

General Background

The University, the only public university in Puerto Rico, developed from a school for the training of public school teachers which opened in 1900. In 1903, the school was incorporated as the University of Puerto Rico, an independent public corporation, and began operations with 154 students. As of August 31, 2006, enrollment of undergraduate, graduate, and professional school students at the University was approximately 65,000, making it the largest Hispanic university in the United States higher education system.

The University is committed to providing education of the highest quality and widest scope to its students. To this end, the University has formulated the following specific goals: to serve as a center for academic and scientific research; to develop applied research; to expand its educational programs which prepare students for employment in industry and commerce; to capitalize on the location of Puerto Rico in the Caribbean region by developing programs germane to the residents of the region; and to develop the University's position as a member of the international academic community.

The foregoing goals are being accomplished through the creation and revision of academic programs to meet the changing needs of local communities; the establishment of inter-unit transfer programs to broaden the educational opportunities offered to students; the strengthening of graduate programs by revising financial aid options, increasing research through highly selective faculty recruitment, and promoting inter-campus collaborative research and teaching; the development of new multi disciplinary academic programs that will provide students with a global vision of the economic, social, and scientific sectors; the creation of focused research centers; the establishment of collaborative agreements with other universities, government agencies, and industries in the United States, the Caribbean. Latin America, and Europe; and increased participation in federally sponsored programs for scientific and medical research.

The University Campuses

The University includes three major campuses and eight additional university campuses located throughout the island. Many of these units have developed important academic specializations. Each campus has developed specific goals which address the local needs of the region and future community development. A description of the campuses including their goals is set forth below.

Río Piedras Campus: Located in the San Juan metropolitan area, it is the oldest and largest of the University's campuses. Enrollment at Río Piedras for academic year 2006-2007 was approximately 20,500 students. The focus of this campus is the development of undergraduate and graduate programs in the arts and sciences. Academic degrees are granted through the Colleges of Humanities, Natural Sciences, Social Sciences, General Studies, Education, Business Administration and Architecture, and the Schools of Law, Planning, Library Sciences and Public Communications. Research centers exist for the study of the Caribbean, HIV/AIDS Education and Prevention, History, Hispanic Studies, Social Sciences, Labor Relations, Cooperativism, Psychology, Engineering, Math and Sciences, Business and Law.

Its National Museum houses the most complete archeological collection of pre-Columbian artifacts from indigenous cultures in the Caribbean, and serves as an important research resource. Its main library is the largest on the island. Its theater, in the Spanish revival architecture tradition, hosted the first Casals Music Festival in 1956 and continues to be a center of cultural activity. The tree-lined Quadrangle dominated by a distinctive clock tower, is listed in the United States National Register of Historic Places.

Mayagüez Campus: Located in the western part of Puerto Rico, it is the second largest campus in the University and has an enrollment of approximately 12,200 students for academic year 2006-2007. It was originally established as a College of Agriculture and Mechanical Arts. Mayagüez now offers graduate and undergraduate programs in engineering, natural sciences, business administration and the liberal arts. The campus has established its credentials in the engineering field, acquiring international recognition. The School of Engineering at Mayagüez ranks ninth in granting engineering degrees in the United States, first in graduating Hispanics and second in graduating women.

Medical Sciences Campus: Founded as the School of Tropical Medicine in affiliation with Columbia University in 1924, it is located in the San Juan metropolitan area adjacent to the Puerto Rico Medical Center and has an enrollment of approximately 3,000 students for academic year 2006-2007. Its purpose is the development of undergraduate and graduate programs in the health sciences professions. This institutional unit offers two-, four- and five-year programs at the first professional, graduate and post-graduate levels. Academic degrees are granted through the Schools of Medicine, Dentistry, Allied Health Professions, Pharmacology, Biosocial Sciences and the Graduate School of Public Health. Post-doctoral programs are offered in medicine, dentistry, public health, pharmacy and other health-related fields.

University of Puerto Rico at Aguadilla: Located in the northwestern part of the island, it has an enrollment of approximately 3,200 students for academic year 2006-2007. Although it began as a two-year regional college, it has added four-year programs in manufacturing quality control, business administration, office systems, and electronic engineering technology.

University of Puerto Rico at Arecibo: Located on the northwestern coast of the island, approximately 50 miles west of San Juan, it has an enrollment of approximately 4,600 students for academic year 2006-2007. The college offers two-year in-transfer programs towards a bachelor's degree, two-year associate's degrees in technical and other programs and four-year programs mainly in technical areas towards a technological bachelor's degree.

University of Puerto Rico at Bayamón: Located in the San Juan metropolitan area, west of San Juan, it has an enrollment of approximately 5,800 students for academic year 2006-2007. It offers two-year in-transfer programs towards a bachelor's degree, two-year associate's degrees in technical and other programs and four-year programs towards a technological bachelor's degree. At this college many of the students study electronics and computer technology. Many students enter the workplace while in school, providing them with an invaluable work-study experience.

University of Puerto Rico at Carolina: Located in the San Juan metropolitan area, east of San Juan, it has an enrollment of approximately 4,300 students for academic year 2006-2007. It offers its students the opportunity to complete their associate's degree studies in sixteen months. The college also offers two-year in-transfer programs towards a bachelor's degree.

University of Puerto Rico at Cayey: Located in the central region of the island, it has an enrollment of approximately 4,000 students for academic year 2006-2007. It offers undergraduate degrees in education, natural sciences, humanities and business. Its biomedical research program is a collaborative effort for students to undertake investigative projects at several laboratories at mainland universities and industrial laboratories while receiving University credit. The Howard Hughes program stimulates first and second year students in the natural sciences to participate in research projects. A Center for Women's Studies and gender-related issues collects, studies and publishes information and sponsors many activities which draw participants from throughout Puerto Rico and the Caribbean.

University of Puerto Rico at Humacao: Located in the eastern part of the island, it has an enrollment of approximately 4,400 students for academic year 2006-2007. It stresses the development of two-year technical and four-year bachelor's degree programs. The development of technical programs is designed to meet local needs. Research and conservation programs focus on endangered species on the island. University of Puerto Rico at Humacao is also responsible for the Roig House Museum, which is housed in an early twentieth century structure designed by an associate of Frank Lloyd Wright, Antonin Nechodoma, who made Puerto Rico his home. The Roig family donated the house to the University, which uses it as a cultural center and exhibit hall.

University of Puerto Rico at Ponce: Located in the southern part of the island, it has an enrollment of approximately 4,000 students for academic year 2006-2007. It offers two-year associate's degrees in technical and other programs, two-year in-transfer programs towards a bachelor's degree, and four-year technical programs for a bachelor's degree. The college offers bachelor degrees in elementary education, business administration, physical therapy, occupational therapy, technology in industrial design or civil engineering, architectural drawing, and other subjects.

University of Puerto Rico at Utuado: Located in the central region of the island, it has an enrollment of approximately 1,600 students for academic year 2006-2007. It offers two-year in-transfer programs towards a bachelor's degree and two-year associate's degrees in technical and other programs, primarily in agricultural technology.

Special Programs

Undergraduate & Graduate Education: Continuous curriculum reviews are undertaken throughout the University. The increased emphasis on program evaluation and accreditation has moved programs to revise and update their curriculum. Special attention is being given to undergraduate education as a whole and in particular to the General Studies component, led by pilot activities at the Río Piedras and Cayey campuses. Each campus is revising its curriculum with the support of the system-wide Vice-Presidency for Academic Affairs ("VPAA"). This initiative is intended to bring academic programs more in line with the social, economic, and technical needs of today's society. Revised programs will be designed to be more flexible, with a broader emphasis on global and interdisciplinary issues. At least four programs have introduced significant curricular changes recognized by the Board of Trustees and by the Puerto Rico Council on Higher Education ("PRCHE") while other programs incorporated minor changes. A significant increase in research projects has been registered across most of the institutional units.

The University has academic programs, both at the undergraduate and graduate levels, that serve as "student magnets," since they are offered only by the University in Puerto Rico. The following are examples of academic programs that serve as "student magnets" at the different campuses:

- Río Piedras Campus – PhD in Chemical Physics, PhD in International Business, Masters in Information Sciences (Library Sciences), Masters in Planning, Masters in Translation, BA in Geography;
- Mayagüez Campus – MS and PhD in Marine Sciences, BS and MS in Geology, BS in Industrial Biotechnology;
- Medical Sciences Campus – Doctor of Pharmacy (PharmD), Doctor of Dental Medicine, MS and Graduate Certificate in Clinical Research, MS in Physical and Occupational Therapy, Graduate Certificate in Clinical Management, Graduate Certificate in School Health Promotion.

Student Exchange Program. The University continues to strengthen its exchange program to provide a broader, more flexible curriculum. Exchange programs have already been established with universities in the mainland United States, Latin America and Spain. A membership application has been approved by the International Student Exchange Program that allows the University to receive more international students and to increase the number of its students studying abroad.

Puerto Rico Resource Center for Science and Engineering. Founded in 1980, the Resource Center for Science and Engineering of the University is a consortium of the island's major institutions of higher education. The mission of the Resource Center is to improve science, mathematics and engineering education. By following a systemic approach, which envisions the educational system as a whole, the Resource Center promotes the transfer of knowledge among educational levels, thus fostering the coherence and high quality of science, mathematics, engineering and technology education in Puerto Rico.

The Resource Center operates as a virtual organization to reform the educational system and to serve as a catalyst and agent of change. As such, the Center maintains linkages with the national reform movement in education and cognitive science, and is also linked closely with the industrial and business communities. The information obtained from these links is transferred to the participating institutions and is then converted into educational strategies, specific objectives, and benchmarks to implement and measure progress of the reform.

The Experimental Program to Stimulate Competitive Research ("EPSCoR"). EPSCoR is a science and technology research and development program sponsored by seven federal agencies. In Puerto Rico, EPSCoR is an island-wide program coordinated by the Resource Center for Science and Engineering. EPSCoR helps researchers, institutions and regions improve the quality and capability of their research in order to compete more effectively for non-EPSCoR research funds. EPSCoR promotes economic development within Puerto Rico by fostering collaborative agreements between industry and academia. EPSCoR research is done primarily at the University's Graduate Centers at the Río Piedras, Mayagüez and Medical Sciences campuses.

Materials Characterization Center, Inc. The Center provides specialized analyses and the corresponding technical and scientific expertise in the areas of Nuclear Magnetic Resonance, Mass Spectrometry, Surface Microscopy and Spectroscopy, and X-Ray Diffraction. The Center was founded through joint collaboration between the Industry University Research Consortium (a consortium that promotes interaction between industry and the academic community in the area of applied research), the Puerto Rico Industrial Development Company and the College of Natural Sciences of the Río Piedras Campus. It is a self-supporting, non-profit corporation affiliated with the University. Its analytical services are provided to industrial, academic and governmental clients.

Governance

Act No. 16 of June 16, 1993 ("Act No. 16"), created a Board of Trustees (the "Board") to act as the governing body of the University. The Board is composed of thirteen members. Two of its members are professors selected by the teaching faculty to serve one-year terms, one member is a student selected by vote of the student representatives to serve a one-year term and the remaining ten members are appointed for staggered six-year terms by the Governor with the advice and consent of the Senate of the Commonwealth. The administration of the University provides both a degree of decentralization responsive to the needs of each institutional unit and a centralized structure through which the activities of each such unit can be coordinated with a view toward the University as a whole. The Board appoints the President, who is the chief executive officer and official representative of the University.

Currently, the Board has eleven sitting members. There are two vacancies to be filled by the Governor. The current members are listed below.

Name	Occupation	Term Ends
Mr. Segundo Cardona, Chairman	Architect	June 16, 2007
José Ramón González, Esq. Vice Chairman	Banker	June 16, 2007
Mr. Rafael Rovira-Passalacqua, Vice Chairman	Engineer	June 16, 2009
Salvador Antonetti Zequeira, Esq., Secretary	Attorney	June 16, 2011
Mr. Carlos H. del Río Rodríguez	Engineer	June 16, 2009
Dr. Javier Morales	Doctor of Medicine	June 16, 2007
Isabel Picó-Vidal, Esq.	Attorney	June 16, 2007
Ygrí Rivera de Martínez, Esq.	Attorney	June 16, 2011
Dr. Luz Ivette Martínez, Faculty Representative	Professor	June 30, 2007
Dr. José A. Peñalbert, Faculty Representative	Professor	June 30, 2007
Ms. Mauryne Rivera Reyes, Student Representative	Student	June 30, 2007

The biographical summaries of the members of the Board are as follows:

Mr. Segundo Cardona, Chairman. Mr. Cardona is an architect and proprietary partner in Sierra, Cardona & Ferrer, an architectural firm in Puerto Rico.

José Ramón González, Esq., Vice Chairman. Mr. González is Chairman and Chief Executive Officer of Banco Santander of Puerto Rico, a commercial bank on the island. Mr. González is a former President of Government Development Bank.

Mr. Rafael Rovira-Passalacqua, Vice Chairman. Mr. Rovira is an industrial engineer. He heads Rovira Biscuit Corporation, a manufacturer of crackers and cookies and a distributor of food products.

Salvador Antonetti Zequeira, Esq., Secretary. Mr. Antonetti is an attorney-at-law and senior partner in Fiddler, González & Rodríguez, a corporate law firm in Puerto Rico.

Mr. Carlos H. Del Río Rodríguez is a chemical engineer. He is President of Pfizer Pharmaceuticals of Puerto Rico. Pfizer is a pharmaceutical company with operations in Puerto Rico.

Dr. Javier Morales is a medical doctor and researcher. He heads Clinical Research Puerto Rico, Inc., a research laboratory on immunological diseases.

Isabel Picó Vidal, Esq., is an attorney-at-law. She is a former member of the Social Sciences faculty at the Río Piedras Campus.

Ygrí Rivera de Martínez, Esq. is an attorney-at-law. Ms. Rivera de Martínez is a retired judge of the Commonwealth's Court of Appeals.

Dr. Luz Ivette Martínez is one of the faculty-elected members of the Board. She is a professor at the University of Puerto Rico at Ponce.

Dr. José A. Peñalbert is one of the faculty-elected members of the Board. He is a professor at the University of Puerto Rico at Carolina.

Ms. Mauryne Rivera Reyes, a student at the University at Bayamón, is the elected student representative.

Administration

Beginning in fiscal year 2000, the Office of the President started its reorganization to better serve the University's academic functions and make possible the achievement of its institutional objectives. First, the former Office of Academic Affairs was transformed into the Vice Presidency for Academic Affairs, thus enhancing the University's ability to confront and respond to the new challenges resulting from the growth and development of the academic programs and functions in the University's multi-campus university system. A Vice President for Academic Affairs heads the new office. Its principal responsibilities include (i) providing advice and assistance to the President in the determination of institutional development, planning, and policy, particularly in areas related to academic matters; (ii) the evaluation of new programs and formulation of recommendations to both the President and the Board; (iii) the assessment of established academic programs to recommend changes and improvements; (iv) the formulation of the development plan, in collaboration with institutional units, to be submitted to the consideration of the President and the Board; and (v) the coordination of all activities related to accreditation and licensing of institutional units, and the accreditation of particular schools and programs, by the several accrediting and licensing agencies. The Vice Presidency for Academic Affairs is charged with the maintenance of a system of institutional information and research to facilitate planning and decision making. The Vice President for Academic Affairs oversees the support to student- related functions and services, including recruitment, admissions, financial aid and cultural activities.

Second, a Vice Presidency for Research and Technology was created to provide structured support to the increasingly broad research activities at the University, promote their growth, and attend to the challenges presented by technology. The new Vice Presidency for Research and Technology (i) assists the President in the formulation, development and implementation of new initiatives and policies to promote research throughout the University; (ii) evaluates and assesses current research activities; (iii) makes recommendations for the consideration of the President and of the Board for the advancement of research projects and activities; (iv) stimulates and assists in the search for external funds to finance research at the University; and (v) proposes and assists in the creation of University policy in this area. The Vice Presidency for Research and Technology is also charged with the evaluation and development of system-wide technological infrastructure, the expansion and continuing support of the University's collaboration with government entities in the area of research and development, as well as alliances with enterprises and institutions in the private sector to achieve collaborative activities in this area.

Third, the establishment of the Office of Physical Development and Infrastructure enabled the University to modernize the planning, development and construction of its physical facilities and infrastructure. That office assists the President in the (i) formulation, development and implementation of the Capital Improvements Plan; (ii) formulation and implementation of policy guidelines that govern said plan; (iii) coordination with the institutional units to attend to their infrastructure needs and assist them in planning for these needs; and (iv) preparation of projections and financing for capital improvements, in coordination with the Office of Finance.

Fourth, with the creation of the Office for Alumni and Development, the University, for the first time, initiated a structured effort to seek alumni contributions and financial support from private sources in the community. This Office is charged with planning and coordinating institutional efforts to seek contributions from the private sector, assisting in the development of the needed resources to perform such function, and improving the institution's communications and relationships with its alumni. The Office also provides support to all initiatives aimed at obtaining major gifts.

The Office of Finance oversees and controls the income and expenses of the consolidated University system and seeks to ensure that the operations are conducted within existing budget requirements and regulations. Its functions are fairly typical of similar offices in institutions of higher education, and include assisting and advising the President on all matters related to the financial affairs of the University, as well as the formulation of institutional policy. Its functions also include the administration of the investments of University funds, including its endowment; the formulation of rules and regulations to address the diverse aspects of institutional fiscal affairs for the consideration of the President and the Board of Trustees; the provision of support to the finance offices of the institutional units; the design, implementation and maintenance of the accounting system of the University; the coordination of activities related with the issuance of bonds and securities; and the administration of the University insurance coverage, among other functions.

The Budget Office assists the President in the formulation of a consolidated budget for the University system for submission to the Board of Trustees. This Office implements budgetary regulations and policies, provides advice and support to the budget offices, reviews the budgets proposed by the Chancellors to attend to the needs of their units, and makes recommendations to the President with respect to them. The Budget Office also prepares studies and projections regarding the University's budgetary needs and use of its funds, and oversees the implementation of the budget.

The names and biographical summaries of certain members of the administrative staff of the University are as follows:

Antonio García Padilla, Esq., was appointed President in November 2001. He received his undergraduate degree in 1974 and his law degree in 1978 from the University and an LL.M. from Yale University, School of Law in 1981. After serving as law clerk to Judge Angel M. Martín of the Supreme Court of Puerto Rico and then to present Supreme Court Justice Stephen G. Breyer when he was a Justice on the United States Court of Appeals for the First Circuit, Mr. García-Padilla returned to Puerto Rico as an Assistant Professor at the University's School of Law, as a Consultant and Adviser to the Chief Justice of Puerto Rico and as Director of the Central Research Panel of the Puerto Rico Supreme Court. He also served as Adviser for Federal Affairs to the Governor of the Commonwealth of Puerto Rico. He was named Associated Dean of the Law School in 1983 and Dean of the Law School in 1986.

Dr. Celeste Freytes was appointed Vice President for Academic Affairs in February 2003. She holds a Bachelor's Degree in psychology from the University. Her master's and doctoral degrees are in Special Education from the University of Missouri and Boston University, respectively. Since 1972, she has worked at the Río Piedras Campus, as the Director of the Caribbean Educational Resource Center for the Hearing Impaired, the Executive Assistant to the Chancellor, the Interim Dean of Academic Affairs, the Director of the Department of Teaching and Curriculum and a Senator of the School of Education. Dr. Freytes is an honorary member of the Puerto Rico Association of Students with Learning Disabilities and was the recipient of the Academic Excellence and Productivity Award at the School of Education. She has coordinated various institutional accrediting committees and has worked extensively as an expert witness for individual and class-action suits.

Dr. Emma Fernández-Repollet was appointed as Vice President for Research and Development in August 2003. She received her Bachelor's Degree in Education from the University of Puerto Rico Río Piedras Campus, her master's degree and a Ph.D. in Physiology from the University of Puerto Rico Medical Sciences Campus, and has completed postdoctoral training in renal physiology at Duke University and the University of North Carolina at Chapel Hill. In 1982, she joined the faculty of the Department of Pharmacology at the University of Puerto Rico Medical School. Dr. Fernández-Repollet helped establish and administer the Research Centers in Minority Institutions (RCMI) Program at the Medical Sciences Campus, has published over forty original research and review articles and book chapters, and is the holder of two patents.

Miguel Rivera Rivera, CPA, was appointed Director of Finance, Central Administration, on July 25, 2005. He holds a Bachelor's Degree in Business Administration from the University of Puerto Rico at Cayey. From 2001until assuming his current position, Mr. Rivera held the position of Assistant Secretary for the Central Accounting Area and Assistant Secretary of Budget and Financial Affairs of the Treasury Department of the Commonwealth.

Prof. Ida de Jesús Collazo was appointed Director of the Office of Planning and Development of the University on January 1, 2002. Professor de Jesús holds a Master's Degree and has undertaken doctoral studies in Economics at the New School for Social Research in New York and in History at the Río Piedras Campus. Since 1983 she has held different positions at the University including the following: Dean of the Faculty of Social Sciences, Río Piedras Campus; professor of Economics; lecturer at the Graduate School of Planning; Chairperson of the Department of Economics, Trustee of the Board and consultant in Higher Education and in Economics.

Mr. Víctor F. Rivera was appointed Director of Human Resources on April 8, 2001. He holds a Bachelor's Degree in Business Administration and a Master's Degree in Public Administration from the University. In addition, he also holds a Ph.D. in Political Science from Florida State University, Tallahassee, Florida. Mr. Rivera has held various high level positions in the human resources fields both in the public and private sectors.

Iván García Zapata, Esq., has been the Director of the Legal Affairs Office since July 23, 2004. He holds a Bachelor's Degree in Business Administration and a Juris Doctor from the University and a Master's Degree in International Law and International Regulations from the Universidad Complutense de Madrid in Spain. Mr. Zapata was an associate at the law firm Saldaña, Saladaña Egozcue & Vallecillo, from 2000-2001 and a senior associate from 2002-2003. Prior to his current appointment, Mr. Zapata held the position of Legal Counsel to the Chancellor at the Medical Sciences Campus since 2003.

Mr. Basilio Rivera was appointed Budget Director of the University in March 2001. He holds a Bachelor's Degree in Business Administration from the University and has completed graduate courses in the University's Public Administration Program. Prior to assuming his current position, Mr. Rivera held the position of Budget Director of the Río Piedras Campus . Mr. Rivera also has held auditing and other administrative positions at the University since 1983.

Accreditation

The Middle States Association of Colleges and Schools ("MSA") accredits degree-granting colleges and universities in the Middle States region, which includes Delaware, the District of Columbia, Maryland, New Jersey, New York, Pennsylvania, Puerto Rico, the U.S. Virgin Islands and several locations abroad. The PRCHE is responsible for accrediting and licensing institutions and programs of higher learning in Puerto Rico. Following the recommendation of the MSA the University has organized the accreditation process in two cycles that include five and six institutional units respectively, as follows:

The first cycle of the accreditation process includes the Río Piedras and Mayagüez Campuses, and the University of Puerto Rico at Cayey, Arecibo and Ponce. These units submitted a self-study document to the MSA and the PRCHE for the years 1995 to 2005. The University as a system chose to present a comprehensive self-study with emphasis on program evaluation, in line with the main priorities already addressed in the University's strategic agenda. This was a unique experience in a number of important ways. For the first time, the University undertook a combined effort to address the process of license renewal by the PRCHE simultaneously with MSA reaffirmation of institutional accreditation. The institution's self-examination took place in light of the MSA's new accreditation standards that emphasize the assessment of student learning and of institutional effectiveness across all main academic and support functions. Broad participation was prioritized in a process that involved several interfaculty committees. Results of this process suggest that the University is already moving to a culture of assessment centered on student outcomes. MSA recommends more emphasis on assessment, particularly on closing the assessment loop, and to focus on the general education component as a guide to student learning assessment. Most of the MSA and PRCHE recommendations are common to most of the units, and are related to the implementation of recent concepts of the new 2002 MSA standards. Four of the five units evaluated were fully accredited. For the remaining one, MSA requested that a new version of the self-study be submitted and will conduct an additional visit to ascertain that the unit has fully integrated the new accreditation standards to their institutional endeavor.

The second cycle includes the following units: Medical Sciences Campus, University of Puerto Rico at Humacao, Bayamón, Carolina, Aguadilla and Utuado. These units owe a Periodic Review report to MSA by the end of the present semester, and are currently in the final stages of completing this task. The units will not receive a MSA site visit, but were visited by the PRCHE for licensing renewal in April 2006.

Faculty and Staff

The following table summarizes the academic credentials of the faculty of the University during each of the five academic years through academic year 2005-2006.

FACULTY

	Academic Year				
Degree	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006
Doctorate	2,280	2,272	2,433	2,434	2,529
Master	2,643	2,645	2,582	2,346	2,524
Bachelor	140	352	174	139	174
Other	77	192	94	98	100
Total	5,140	5,461	5,283	5,017	5,327

As of August 31, 2006, the University had approximately 14,000 employees. The professors of the University are not unionized. For academic year 2005-2006, the University had approximately 8,670 non-academic support personnel at its various campuses and colleges. Contractual letters of agreement set forth terms of employment and are negotiated through three non-teaching labor associations. As of August 31, 2006, approximately 6,775 non-academic support personnel belonged to these associations, which have been recognized by the Board. Agreements with two of the associations expire on June 30, 2007, and the third association's agreement expires on June 30, 2008. The University considers its relationship with its employees to be good.

Strategic Planning

The core mission of the University is to promote and increase learning by means of the arts and sciences and to contribute to the development and enjoyment of the ethical and esthetic values of our culture. In order to achieve this mission, the University, among other things, must promote the pursuit of knowledge, preserve and enhance cultural values, promote the development of its students, develop the intellectual and spiritual resources of the people of Puerto Rico, and collaborate with other agencies in the study of the problems of Puerto Rico.

The University has worked extensively in the development of a planning document, conceived to evolve over time, to integrate the specific priorities of the academic units of the system, as well as input from the internal and external environment. As a result of the analysis carried out jointly by the President and the Chancellors of the University, a document entitled *Diez para la Década: Agenda para la Planificación* - A Ten-Point Planning Agenda for the Coming Decade - was formally adopted in June 2006.

The ten development areas or specific objectives set forth therein are:

- Constant and continuous interaction with students;
- Academic cultures that welcome experimentation and renewal;
- Competitive research;
- Leadership in community involvement and cultural activities;
- Development of a global vision;
- Efficiency and beauty in natural and constructed spaces;
- Technological overhaul;
- Administrative and managerial optimization;
- Strengthened institutional identity; and
- Development of a culture of institutional assessment and evaluation.

As noted, one of the core areas in the University planning process concerns infrastructure and environment. In addition to the submission of this issue for further analysis and dialogue among University constituencies, several policies and regulations have already been enacted. Some of these are:

- Capital Improvements Plan for the University for years 2003-2004 to 2006-2007, as revised;
- Regulations for Capital Improvement Bids at the University;
- Institutional Policy regarding Public Art at the University;
- Institutional Policy for the Promotion of Excellence in the Design of Buildings and Open Spaces;
- New regulations for naming buildings and open spaces at the University;
- General Policy for Drafting, Developing and Financing the Capital Improvement Program of the University;
- Board Resolution instructing the President to incorporate in the Capital Improvements Plan the requirement of evidence of optimal utilization of the capacity of available facilities of each unit before the approval of architectural plans and to instruct the Chancellors to articulate this process in their respective units; and
- Ratification of the Norms for the Institutional Planning, Administration, Construction and Maintenance of the Capital Improvements at the University.

Admission Requirements and Academic Standards

The University has consistently sought to attract and maintain a high-quality student body by establishing competitive admission standards, requiring maintenance of class standing and setting graduation requirements. The University has revised its recruitment strategy to aggressively promote its curricular offerings to prospective candidates. Admission and orientation counselors have increased their high school visits, exhibitions have been presented at large shopping malls, and regional orientation meetings have been organized for high school advisors.

Admission Requirements. Candidates for admission to the freshman class of the University must have a high school diploma or its equivalent from an educational institution duly accredited by Puerto Rico's Department of Education. Each institutional unit of the University establishes its individual entrance requirements. Admission generally is determined according to an admission index formula which gives consideration to both the candidate's score on an entrance examination sponsored by the College Board and administered by the Educational Testing Service of New Jersey, and his or her high school academic grade point average. The admission formula is designed to reduce attrition, boost enrollment levels, and increase overall student success. The admission formula is periodically reviewed in an effort to refine its predictability by incorporating program-specific requirements where determined necessary. During the past four years the average admission index score of students accepted by the University has increased.

Academic Standards. Each student at the University must maintain the minimum grade point average required by his or her institutional unit. In the event that such average falls below the required level, the student is placed on probation for one year, during which time he or she receives special assistance to help improve his or her academic performance. Those students who do not achieve the minimum grade point average at the end of the probation period are suspended for academic deficiency.

Graduation Requirements. In order to receive a degree, diploma or certificate from the University, a student must, within the limits established by his or her institutional unit, complete the specified courses of study with the minimum required grade point average of 2.0.

The following table shows the number and types of degrees granted during each of the four years through the 2005-2006 academic year.

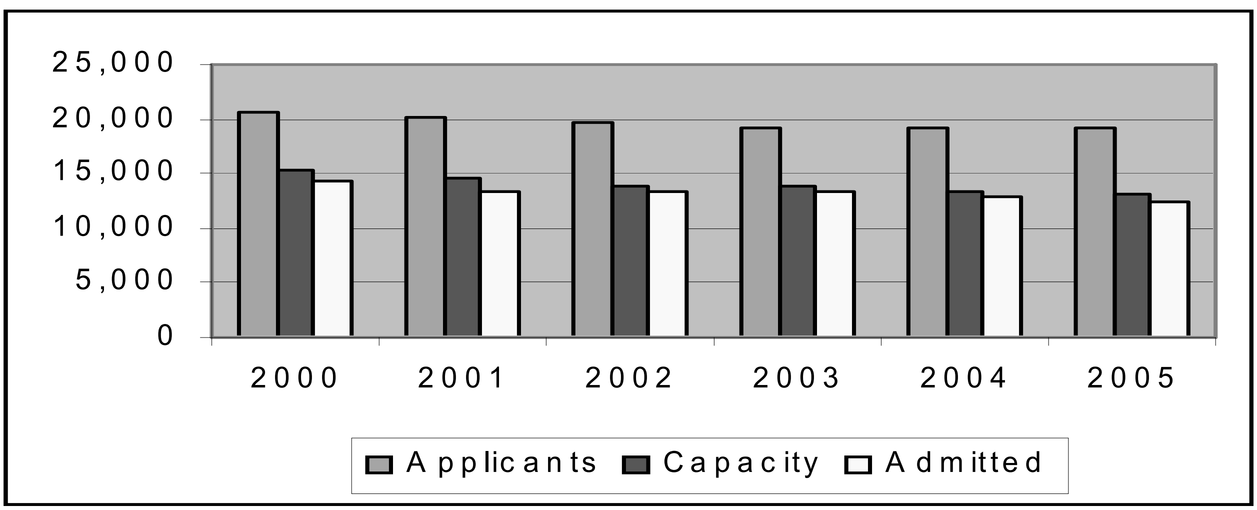
DEGREES GRANTED

	Academic Year				
Degree	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006
Certificate-Undergraduate	39	46	42	25	0
Certificate-Graduate	117	153	139	180	197
Associate	857	759	668	557	605
Bachelor	7,952	8,114	7,928	7,466	7,352
Master	720	647	703	695	779
Doctorate	76	77	81	72	108
First Professional[1]	285	299	344	348	329
Total	10,046	10,095	9,905	9,343	9,370

[1] The first professional level includes the academic degrees in law, medicine and dentistry.

Student Enrollment

The following chart shows, since 2000, the number of applicants, the carrying capacity of the University and the number of admitted freshmen:



The chart shows a 6.5% decrease in the number of applicants, a 13.7% decrease in the number of admitted students, and a decrease of 13.1% in carrying capacity for the academic years 2000-2001 through 2005-2006. Meanwhile, the total occupancy of the University for the same period has fluctuated between 91.2% for 2001 and 97.8% for 2003, with a total capacity at 93.1% in 2005.

In 2000, 65% of students in Puerto Rico taking the College Board applied for admission to the University, whereas 63% of such students applied for admission in 2005. The decrease in the absolute number of applicants was affected by a decrease in the number of students taking the College Board examination.

There has been a tendency toward a more selective admission process for freshmen admissions. The admission rate for 2000 was 69.1%, whereas for 2005 it was 64.2%. The University has, by far, the most selective admission rate of all institutions of higher education in Puerto Rico, and it ranks among institutions in the mainland considered "Very Competitive," according to Barron's Selectivity Criteria.

With respect to enrollment, there has been a steady increase in graduate enrollment during the period under discussion. In academic year 2000-2001, graduate students accounted for 9.5% of total enrollment, whereas in 2004-2005 they represented 11.2% of total enrollment (from 6,721 graduate students in 2000-2001 to 7,485 in 2004-2005).

For academic year 2005-2006, the student body of the University consisted of approximately 64,400 students. While the number of students has decreased by approximately 2,500 over the last five years, recent five-year projections indicate that the University's undergraduate student population is expected to remain stable. The University anticipates further growth in the percentage of graduate students, as has been the tendency since academic year 1995-1996. The following table shows the historical student enrollment at the University.

HISTORICAL STUDENT ENROLLMENT[1]

	Academic Year				
	2001-2002	**2002-2003**	**2003-2004**	**2004-2005**	**2005-2006**
Undergraduate:					
Two-Year	5,732	5,946	5,131	5,364	4,475
Transfer Programs	5,027	4,296	3,956	5,364	3,873
Four- and Five-Year	51,728	51,739	52,157	49,083	48,727
Graduate:	6,721	7,083	7,383	7,242	7,396
Total	69,208	69,064	68,627	67,053	64,471
Full-time equivalent (based upon a course load of 24 credits per academic year)	62,639	63,135	61,950	62,141	60,135

1 *Source*: University of Puerto Rico.

Tuition and Other Fees

The academic year is divided into two semesters (mid-August to mid-December and mid-January to mid-May) and a shorter summer session (early June to late July).[1] The most recent revision of tuition fees occurred at the beginning of the 2004-2005 academic year when rates were raised from $30 to $40 per credit for undergraduate courses and $75 to $100 per credit for graduate level courses. At the end of such 2004-2005 year period, tuition levels at the University were, and as of the date of this Official Statement such tuition levels remain, below comparable tuition levels at all private institutions of higher education in Puerto Rico.

Resident Students

The following table shows the tuition fee per credit and the student and medical fees per semester for students who are residents of Puerto Rico.

TUITION AND OTHER FEES—GENERAL

	First Semester	Second Semester
Tuition fees per credit:		
Technical programs or associates degrees	$40	$40
Undergraduate students	40	40
Graduate students		
Graduate programs (including law school)	100	100
Industrial pharmacy	120	120
Post-bachelor programs (per academic year)	1,330	N/A
Student fees:		
Maintenance fee (all students)	47	47
Laboratory fee (per lab)	33	33
Technology fee	25	25
Medical fees:		
Basic Medical Plan:		
All students - second semester includes summer session	248	347
Summer session - students not studying during previous second semester	99	N/A
Medical Plan including pharmacy:		
All students - second semester includes summer session	543	760
Summer session - students not studying during previous second semester	217	N/A
Miscellaneous fees:		
Graduation fee (payable only in the last semester)	27	27
Late registration fees	13	13
Transfer petition fee	$20	$20

Full-time undergraduate students (12 credits) pay approximately $585 per semester for tuition and fees.

[1] The University of Puerto Rico at Carolina divides its academic year into trimesters.

TUITION AND OTHER FEES---MEDICAL SCHOOL AND DENTAL SCHOOL

	Per Academic Year
Tuition	$6,650
Medical service fee	594
Medical service fee (including drug coverage)	1,302
Laboratory fee (per lab)	33
Graduation fee (payable in the last semester)	27
Maintenance fee (all students)	141

Nonresident Students

Students who are not residents of Puerto Rico pay a tuition fee in excess of that charged to resident students. The total number of nonresident students attending the University during the 2005-2006 academic year was 589.

RECENT DEVELOPMENTS OF THE COMMONWEALTH

This section summarizes and updates certain information about the Commonwealth's current fiscal situation appearing in the Commonwealth Report. This section should be read in conjunction with the information included in the Commonwealth Report, which shall be deemed modified to the extent the information provided therein is different from that appearing below.

The Commonwealth's Budget Deficit for Fiscal Year 2006, Its Structural Budget Imbalance and Other Fiscal Challenges

Estimated Budget Deficit for Fiscal Year 2006. Unaudited total revenues for fiscal year 2006, according to the Secretary of the Treasury, were $8.645 billion (including $100 million of proceeds generated by the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A, which were privately placed). This amount is $350 million less than the amount originally budgeted of $8.995 million. This reduction in revenues is attributable primarily to the current economic slowdown, caused mainly by the price of oil and its derivatives having been at a historically high level, the government's fiscal crisis, which resulted in a two-week shutdown of non-essential government services in May 2006, and the uncertainty that prevailed during the later part of fiscal year 2006 regarding the enactment of proposed tax and fiscal reform measures designed to resolve the fiscal crisis. The Commonwealth does not expect these reduced revenue levels to continue during fiscal year 2007. Total expenditures for fiscal year 2006 were $9.683 billion, or approximately $1.0 billion above the estimate of total revenues for fiscal year 2006. Taking into account certain additional General Fund cash requirements in the amount of $368 million that were covered by alternative financing mechanisms, the fiscal year 2006 budget deficit totals approximately $1.4 billion. See "Commonwealth's Structural Budget Imbalance" below. The excess expenditures experienced during fiscal year 2006 (totaling $1.0 billion) were partially covered with funds from the Emergency and Budgetary Funds ($64 million) and a Government Development Bank for Puerto Rico ("GDB" or "Government Development Bank") loan ($741 million). The remaining shortfall, totaling $233 million, did not have a cash impact during fiscal year 2006 as a result of various cash management mechanisms, including the postponement of certain payments to third party vendors. This shortfall has had an impact on the Commonwealth's cash flow during fiscal year 2007.

The excess expenditures of $1.0 billion do not include other expenditures related to fiscal year 2006 which had been excluded from the fiscal 2006 budget, such as certain vendor debts of $268 million from prior fiscal years and $368 million of debt service due during fiscal year 2006 on the Commonwealth's general obligation bonds, which was paid from the proceeds of a Government Development Bank loan and refunded with the proceeds of the Commonwealth Public Improvement Refunding Bonds, Series 2006 B and C (the "Financed Debt Service"). These excluded expenditures are referred to as the "Additional Expenditures."

Commonwealth's Structural Budget Imbalance. The budget imbalance in fiscal year 2006 comes in the wake of several recent fiscal years during which the Commonwealth's recurring expenditures exceeded its recurring revenues. These budget imbalances were covered in the past with loans from Government Development Bank, financing transactions (including long-term bond issues payable from the General Fund) and other non-recurring resources. The Commonwealth's recurring operating expenditures during fiscal year 2006 exceeded recurring revenues (the so-called structural imbalance) by approximately $1.2 billion, compared to $1 billion for fiscal year 2005. The $1.2 billion structural imbalance for fiscal year 2006 is the difference between expenditures of $9.683 billion plus the Financed Debt Service, for a total of $10.05 billion, less budgeted recurring revenues of $8.895 billion. The calculation of the $1.2 billion structural imbalance excludes (i) the $350 million reduction in revenues during fiscal year 2006 discussed above because the government does not consider it a permanent reduction in recurring revenues and (ii) net proceeds of $100 million received in fiscal year 2006 from the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A, which is non-recurring. The amount of estimated expenditures also does not take into account the Additional Expenditures discussed above, which, if considered recurrent, would increase the structural budget imbalance. The Commonwealth covered the fiscal year 2006 structural imbalance by financing the Financed Debt Service ($368 million), issuing the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A ($100 million), transferring approximately $64 million from the Emergency and Budgetary Funds and financing most of the remaining portion of the Commonwealth's fiscal year 2006 structural budget imbalance with a GDB loan of $741 million. In addition to the aforementioned vendor debts and the Financed Debt Service, there are certain other expenditures not included in the amount of unaudited expenditures for fiscal year 2006 that may increase the structural imbalance. These include estimated amounts required to cover maintenance expenses incurred by Public Buildings Authority ("PBA") (approximately $75 million) and subsidy and operational expenses incurred by the Agricultural Services and Development Administration ("ASDA") (approximately $75 million). These last two items are covered by lines of credit from Government Development Bank collateralized by real estate of ASDA and PBA and accounts receivable of PBA, with payment expected from the sale of such pledged real estate and/or the collection of such pledged receivables. For more information, see "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in the Commonwealth Report.

Other Fiscal Challenges. Other than its current budgetary shortfalls, the principal challenge facing the Commonwealth involves resolving the increasing unfunded pension liability of the Employees Retirement System and the Teachers Retirement System, which totaled $9.2 billion as of June 30, 2003 and $2.3 billion as of June 30, 2004 respectively. The Commonwealth expects to reduce the unfunded liability of the Employees Retirement System through proposed legislation providing for increased employer and employee contributions and the issuance of up to $2 billion of pension obligation bonds, which would be payable from the Commonwealth's General Fund, and, subject to regulatory approval and other conditions, the sale of its remaining Puerto Rico Telephone Company ("PRTC") stock for approximately $500 million, which the Employees Retirement System expects to invest in higher-yielding assets. The Employees Retirement System and the Teachers Retirement System are seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits. The Employees Retirement System is seeking reimbursement from the Commonwealth in the amount of $77.4 million for cumulative benefits paid to beneficiaries through June 30, 2005. The Employees Retirement System projects an additional shortfall of $39.4 million for fiscal year 2006 in connection with payments pursuant to special benefit laws. The Office of Management and Budget ("OMB") believes that the basis of the claims from the Employees Retirement System is valid but that the amounts claimed remain to be verified and reconciled. Recently, the Employees Retirement System received a $42.9 million payment from OMB to cover shortfalls related to payments made in connection with special benefits laws. OMB does not recognize as a Commonwealth liability part of the claims by the Teachers Retirement System ($119 million). OMB and the Teachers Retirement System are currently under inter-agency arbitration in an effort to resolve their differences.

For more information about the retirement systems and their finances, see *Retirement Systems* in the Commonwealth Report.

Tax and Fiscal Reform and Government Reorganization Plan

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislative Assembly enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales tax. The fiscal reform legislation is aimed at limiting expenditures relative to past spending rates and reducing expenditure growth to a level below that of recurring revenues.

Tax Reform. Act No. 117 of July 4, 2006 ("Act 117") amends the Puerto Rico Internal Revenue Code of 1994 (the "PR Code") to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the "Central Government Sales Tax") and authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the "Municipal Sales Tax" together with the Central Government Sales Tax, the "Sales Tax"). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods) and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. The Sales Tax is imposed on the sale, use, consumption and storage of taxable items, which include tangible personal property, taxable services, admission rights and certain other types of transactions covering separable and identifiable taxable items which are sold for a single price, subject to certain exceptions and limitations provided therein. The Sales Tax will not be imposed on, among other things: (i) taxable items acquired by merchants for resale, (ii) taxable items acquired by manufacturing plants, (iii) taxable items acquired for use and consumption outside of Puerto Rico, (iv) certain food products that do not need to be heated before their sale, (v) prescription drugs, (vi) the rental payments received by a lessor of real property which is used for residential or commercial purposes, (vii) services provided by designated professionals, (viii) cash, cash equivalents, stocks, bonds, notes, mortgage loans, insurance, securities and interest derived for the use or forbearance of money, (ix) sales of real property, and (x) leases in which the Industrial Development Company is the owner of the property. Act 117 also repeals the 5% general excise tax imposed on certain imported goods and on goods manufactured in Puerto Rico. Other items, such as fuel, crude oil and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items and will not be subject to the Sales Tax.

The Sales Tax became effective on November 15, 2006 and the effective date of the repeal of the 5% general excise tax was October 17, 2006. Municipalities were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and many have already done so. The revenues derived from the Sales Tax will be distributed as follows: (i) municipal governments will retain 1.3% of the Sales Tax, (ii) the Financial Assistance Fund, created by Act No. 91 of May 13, 2006, as amended, will receive 1% of the Sales Tax, and (iii) the General Fund will receive 4.7% of the Sales Tax. The Secretary of the Treasury projects that each percentage point of the Sales Tax will generate annually approximately $191 million of gross revenues and that the Sales Tax will generate total annual gross revenues of approximately $1.337 billion. The revenues to be generated by the Sales Tax will be partly offset by the elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provides for special income tax rates with respect to certain transactions occurring on and between July 1, 2006 and December 31, 2006. These special tax rates will apply to eligible dividends declared by domestic corporations or partnerships and "built-in" gains associated with capital assets held for periods in excess of six months. These special tax rates are only available for transactions in connection with capital assets consisting of stock or participation of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates apply only to real property located in Puerto Rico. The proceeds of this measure are assigned by the legislation to the payment of the $741 million GDB loan mentioned above. The Secretary of the Treasury expects the aforementioned provisions of Act 117 to generate approximately $264 million by December 31, 2006. The Legislative Assembly approved, but later recalled, a bill authorizing an increase of the Sales Tax by up to 1% by executive order of the Governor if these Act 117 provisions did not generate $1 billion by December 31, 2006. It is uncertain whether new legislation to grant such authorization to the Governor will be approved.

On October 31, 2006 the Supreme Court of Puerto Rico granted certiorari to a group of plaintiff taxpayers that sought declaratory judgment alleging that the House of Representatives intended to enact a 5.5% aggregate sales and use tax, including the portion attributable to the municipalities. On November 10, 2006, the Supreme Court, in a majority decision, ruled against the plaintiffs and held that Act 117 is clear that the Sales Tax is comprised of the Central Government Sales Tax and the Municipal Sales Tax, for an aggregate Sales Tax of 7%.

Fiscal Reform. On May 25, 2006, the Governor signed legislation providing for a fiscal reform of the Commonwealth government (the "Fiscal Reform Legislation"). The Fiscal Reform Legislation applies to every instrumentality and entity of the Executive Branch funded, in whole or in part, from the General Fund and sets forth as the public policy of the Commonwealth the reduction of government spending, the elimination or consolidation of redundant agencies, the reduction of government payroll without causing the layoff of regular employees or increasing the actuarial liability of the retirement systems, the limitation of unnecessary, extravagant or excessive spending, and the limitation of public relations and other similar expenses. For more information on the Fiscal Reform Legislation, see "Fiscal Reform" under *Budget of the Commonwealth of Puerto Rico* in the Commonwealth Report. Despite his approval of the Fiscal Reform Legislation, the Governor has stated that certain of its provisions may be unconstitutional because they infringe on Executive Branch prerogatives. As such, the Governor has informed the Legislative Assembly that certain provisions of the Fiscal Reform Legislation will be implemented at the Executive Branch's discretion and through the use of the Executive Branch's prerogatives. There is no assurance that the Fiscal Reform Legislation will generate the expected savings or that it will be implemented as enacted.

The Government Economic Development and Government Transformation Plan. On October 22, 2006, the Commonwealth issued the "The Economic Development and Government Transformation Plan for Puerto Rico" ("the Plan"). The Plan's purpose is to establish strategies to develop the economy of the Commonwealth and ensure that it competes successfully with the economies of other countries. The Plan focuses on six main strategies which consist of: (i) improving infrastructure; (ii) developing bio-sciences and high-technology industries; (iii) promoting local industry; (iv) expanding tourism to promote further economic development; (v) reducing petroleum dependency to 50% (currently at 73%) in four years; and (vi) transforming the government's structure by decentralizing services and using principles of regionalization.

Fiscal Year 2007 Budget

On July 10, 2006, the Governor signed a General Fund budget for fiscal year 2007 authorizing expenditures of $9.488 billion, or approximately $195 million less than the expenditures for fiscal year 2006 of $9.683 billion (excluding the Additional Expenditures). This reduction of approximately $195 million is attributable principally to decreases in the amount allocated to the Department of Education and certain health-related expenditures. Currently, the Department of Education is working on an internal restructuring to reduce its expenditures so as to remain within its reduced operating budget. On November 19, 2006 the Governor signed into law a legislative measure authorizing Government Development Bank to extend a $253 million loan to the Commonwealth to cover certain health-related expenditures. The State Insurance Fund will guarantee the loan and repay it in six years.

The revenue projection for fiscal year 2007 is $9.163 billion, an increase of $618 million, or 7.2%, from preliminary net revenue collections for fiscal year 2006 of $8.545 billion. The Secretary of the Treasury's revenue projection for fiscal year 2007 consists of $8.899 billion, a 4.1% increase over fiscal year 2006, and $264 million to be generated by certain non-recurring tax measures. See "Tax and Fiscal Reform and Government Reorganization Plan - Tax Reform" above. The revenue projection for fiscal year 2007 reflects (i) the Planning Board's downward revision of its forecast for real growth in gross national product from 2.5% to 0.6%, (ii) the implementation of the Sales Tax (4.7% of which Sales Tax is allocated to the General Fund) starting on November 15, 2006 through June 30, 2007, (iii) the elimination of the 5% general excise tax, and (iv) certain income tax rate reductions included in the tax reform legislation. For more information, see "Summary and Management's Discussion of General Fund Results - Fiscal Year 2007 Projected Revenues" under *Puerto Rico Taxes, Other Revenues, and Expenditures* in the Commonwealth Report.

The revenues projected by the Secretary of the Treasury for fiscal year 2007 include approximately $643 million from the implementation of the Sales Tax. This amount consists of the 4.7% allocable to the General Fund for the period from November 15, 2006 through June 30, 2007. The impact of the repeal of the excise tax revenue on projections for the period between October 17 and November 15, 2006 is a reduction of approximately $50 million. The Commonwealth's budgeted expenditures for fiscal year 2007 of $9.488 billion exceed projected revenues of $9.163 billion by approximately $325 million. In addition, the Commonwealth must cover a $233 million cash shortfall relating to fiscal year 2006 and a $51 million cash shortfall relating to fiscal year 2007 consisting of (i) certain payments excluded from the fiscal year 2007 budget and (ii) temporary differences in cash flow during fiscal year 2007. The Commonwealth expects to eliminate this budget deficit and cash shortfall totaling $619 million through the implementation of additional expenditure reducing measures, a possible increase in tax revenues resulting from the reduction of the uncertainty surrounding the government's fiscal crisis, and cash management mechanisms. Among such measures, OMB has established a ten percent reserve from the budgeted amounts of certain agencies totaling $540 million. Funds from these reserves may be used by the agencies only with OMB approval. The possible increase in tax revenues may be tempered by a number of factors, including without limitation, the adverse economic impact resulting from increases in the price of oil and the implementation of the Sales Tax.

The Commonwealth has also excluded, based on the provisions of Act No. 91 of May 13, 2006, from the fiscal year 2007 budget approximately $522 million of debt service payments on its outstanding appropriation debt. Of this amount, Government Development Bank advanced and, on July 15, 2006, deposited with the trustee $303 million corresponding to debt service of the Public Finance Corporation. The remaining $219 million of debt service payments is owed by the Commonwealth to GDB. Additional debt service requirements for fiscal year 2007 will be covered with amounts to be deposited in the Financial Assistance Fund, a special fund created by Act No. 91 of May 13, 2006, as amended. The Financial Assistance Fund will be funded mainly with one-seventh of the Sales Tax, which is expected to generate annually approximately $191 million. However, due to the implementation of the Sales Tax on November 15, 2006, the Fund is expected to receive approximately $136.8 million for the seven and a half months in fiscal year 2007 for which the Sales Tax will be in effect. The Commonwealth is currently evaluating various restructuring alternatives for its outstanding appropriation debt, some of which may require legislative approval, in order to cover these debt service payments with the expected revenues of the Financial Assistance Fund. Based on previous legislation, amounts not covered by the Financial Assistance Fund, if any, would have to be covered by additional legislative appropriations from the Commonwealth's General Fund.

Recent Rating Actions

Recent Commonwealth Rating Action. On July 20, 2006, Standard & Poor's Rating Services, a Division of The McGraw-Hill Companies, Inc. ("S&P"), confirmed its "BBB" and "BBB-" rating on the Commonwealth's general obligation debt and appropriation debt, respectively, and removed the rating from CreditWatch with negative implications, where it had been placed on March 22, 2006. S&P's ratings outlook, however, remains negative. On July 21, 2006, Moody's Investors Service ("Moody's") confirmed its "Baa3" and "Ba1" rating on the Commonwealth's general obligation debt and appropriation debt, respectively, and removed the ratings from Watchlist with negative implications, where it had been placed on February 24, 2006. Moody's ratings outlook, however, also remains negative.

Previous Commonwealth Rating Action. On March 22, 2006, S&P placed the Commonwealth's rating on CreditWatch with negative implications as a result of the Commonwealth's anticipated budget deficit for fiscal year 2006, slow progress on tax and fiscal reform and the apparent political impasse regarding these measures. This action had been preceded in May 2005 by a reduction in S&P's rating of the Commonwealth's general obligation debt and appropriation debt rating from "A-" to "BBB" and from "BBB" to "BBB-," respectively.

Recent University Rating Action. On November 29, 2006, S&P affirmed its rating of "BBB" on the University's outstanding bonds. Additionally, S&P affirmed its rating of "BBB-" on the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority's Series 2000A bonds, issued for the benefit of the University for the development of Plaza Universitaria. S&P's long-term rating outlook for the University's outstanding bonds continues to be negative.

Moody's placed the University's rating on Watchlist with negative implications in February 2006, in conjunction with the action it took with regard to the rating of the Commonwealth. In July 2006, after Moody's removed the Commonwealth's rating from Watchlist, it maintained the University's rating on Watchlist pending review. On October 25, 2006, Moody's removed the University's rating from Watchlist and confirmed the "Baa2" unenhanced bond rating on the University with a negative outlook.

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HIGHER EDUCATION IN PUERTO RICO

During the past four decades, Puerto Rico has made significant advances in the field of education, particularly at the undergraduate and graduate levels. The transformation of Puerto Rico during the 1950s and 1960s from an agricultural economy to an industrial economy brought about an increased demand for education at all levels. Since 1970, the manufacturing sector has attracted high technology industries to Puerto Rico. More recently, service sector employment has increased significantly. This has resulted in an increased demand for personnel having a higher level of education in general and greater expertise in various technical fields in particular. During the same time period, enrollment in institutions of higher learning has risen very rapidly. Although the growth in college age population has slowed due mainly to demographic factors, the increasing proportion of college attendance by the college age population and adults returning to college for advanced training, retraining or to obtain degrees has stabilized the enrollment levels.

The following table presents college enrollment figures for Puerto Rico and the United States:

PUERTO RICO AND UNITED STATES COLLEGE ENROLLMENT

	Puerto Rico			United States		
Year	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent**	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent**
1970	341,448	57,340	16.8%	23,714,000	8,580,887	36.2%
1980	397,839	130,105	32.7%	30,022,000	12,096,895	40.3%
1990	417,636	156,147	37.4%	26,961,000	13,621,000	50.5%
2000	428,892	176,015	41.0%	27,143,455	15,312,000	56.4%
2004	416,020	206,791	49.7%	29,245,102	17,095,000	58.4%

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

In addition to the University, there are forty public and private institutions of higher education in Puerto Rico. Such institutions have a current enrollment of approximately 138,700 students and provide programs of study in liberal arts, education, business, natural sciences, technology, secretarial and computer sciences, nursing, medicine and law. Degrees are offered by these institutions at the associate, bachelor, master and doctoral levels.

The following table presents data on higher education enrollment in Puerto Rico for the ten academic years ended 2005-2006.

HIGHER EDUCATION ENROLLMENT IN PUERTO RICO

Academic Year	Total Enrollment	Enrollment in University of Puerto	Enrollment in Other Institutions
1996-1997	173,233	67,146	106,087
1997-1998	173,318	69,540	103,778
1998-1999	174,936	69,277	105,659
1999-2000	176,015	69,749	106,053
2000-2001	184,126	69,552	114,574
2001-2002	190,776	69,208	121,568
2002-2003	199,842	69,064	130,778
2003-2004	206,791	68,627	138,164
2004-2005	207,074	67,053	140,021
2005-2006	209,547	64,471	145,076

Source: Puerto Rico Council on Higher Education.

Puerto Rico Council on Higher Education

The PRCHE, created pursuant to Act No. 17 of June 16, 1993, as amended, is responsible, generally, for the promotion of higher education in Puerto Rico. More specifica1ly, however, the PRCHE is charged with the establishment of information systems and the design of evaluation models and indicators of use for the planning of higher education. It is also responsible for accreditation and licensing of institutions and programs of higher learning in Puerto Rico, including the University, the management of certain Commonwealth, federal and private funds allocated to support higher education programs and the promotion of continuing professional education programs.

DEBT

The following table sets forth the Bonds and notes of the University outstanding as of June 30, 2006 and as adjusted for the issuance of the 2006 Bonds, the refunding of the Refunded Bonds and the retirement of one of the University's line of credit with GDB at December 13, 2006.

	As of June 30, 2006 (Unaudited)	As Adjusted
	(in thousands)	
Bonds		
Publicly Offered	$373,653[1]	$619,518
HUD[2]	789	789
HHS[2]	1,023	1,023
Plaza Universitaria[3]	84,080	82,665
Total Bonds	459,545	703,995
Lines of Credit[4]		
No. 1	71,414	0
No. 2	8,212	13,305
Total Lines of Credit	79,626	13,305
Total Bonds and Lines of Credit	$539,171	$717,300

(1) Amount does not include accrued and unpaid interest with respect to capital appreciation bonds.

(2) Purchased directly by the United States Department of Housing and Urban Development or the United States Department of Health and Human Services, as applicable.

(3) Obligation of the University under a financing lease regarding a dormitory administrative office complex called Plaza Universitaria, see "Projected Capital Improvements Program" below. The University's obligations under said lease are subordinated to its obligations on the Bonds.

(4) The University has available two line of credit agreements with Government Development Bank for the total authorized amounts of $100,000,000 and $60,000,000. Advances under these agreements bear variable interest rates and are payable on a monthly and annual basis. The $60,000,000 line of credit is paid from legislative appropriations from the Public Improvement Fund.

PRINCIPAL AND INTEREST REQUIREMENTS

Principal and Interest Requirements as defined in the Trust Agreement means, for any fiscal year, the sum of the amounts required to pay (a) the interest on all University bonds which is payable on December 1 and June 1 in such fiscal year, (b) the principal of the serial bonds payable on June 1 in such fiscal year, and (c) the amortization requirement for the term bonds in such fiscal year, less payments under any debt service grant program of the United States Government or any agency thereof.

	Outstanding Bonds (excluding debt service on Refunded Bonds)	2006 Bonds			All Bonds
Fiscal Year Ending June 30	Principal and Interest Requirements	Principal	Interest	Total Debt Service Requirements	Aggregate Debt Service Requirements
	(in thousands)				
2007	$ 25,604,876	0	12,743,500	12,743,500	38,348,376
2008	17,595,528	4,165,000	27,307,500	31,472,500	49,068,028
2009	18,197,803	4,375,000	27,099,250	31,474,250	49,672,053
2010	12,992,055	8,600,000	26,880,500	35,480,500	48,472,555
2011	17,744,380	10,585,000	26,450,500	37,035,500	54,779,880
2012	15,104,995	12,295,000	25,921,250	38,216,250	53,321,245
2013	12,685,000	17,245,000	25,306,500	42,551,500	55,236,500
2014		18,110,000	24,444,250	42,554,250	42,554,250
2015		19,015,000	23,538,750	42,553,750	42,553,750
2016		19,970,000	22,588,000	42,558,000	42,558,000
2017		20,965,000	21,589,500	42,554,500	42,554,500
2018		22,010,000	20,541,250	42,551,250	42,551,250
2019		23,115,000	19,440,750	42,555,750	42,555,750
2020		24,270,000	18,285,000	42,555,000	42,555,000
2021		25,480,000	17,071,500	42,551,500	42,551,500
2022		26,760,000	15,797,500	42,557,500	42,557,500
2023		28,095,000	14,459,500	42,554,500	42,554,500
2024		29,505,000	13,054,750	42,559,750	42,559,750
2025		30,975,000	11,579,500	42,554,500	42,554,500
2026		20,555,000	10,030,750	30,585,750	30,585,750
2027		21,585,000	9,003,000	30,588,000	30,588,000
2028		22,660,000	7,923,750	30,583,750	30,583,750
2029		23,790,000	6,790,750	30,580,750	30,580,750
2030		24,985,000	5,601,250	30,586,250	30,586,250
2031		12,795,000	4,352,000	17,147,000	17,147,000
2032		13,435,000	3,712,250	17,147,250	17,147,250
2033		14,110,000	3,040,500	17,150,500	17,150,500
2034		14,815,000	2,335,000	17,150,000	17,150,000
2035		15,555,000	1,594,250	17,149,250	17,149,250
2036		16,330,000	816,500	17,146,500	17,146,500

CURRENT FUNDS, REVENUES AND EXPENDITURES

Historical

Basic operations of the University are accounted for in current funds. Restricted current funds may be expended only for the purposes established by the source of such funds. For example, federal grants for student scholarships may be used only for that purpose. Federal and Commonwealth grants are the major sources of revenues for restricted current funds, with a large proportion of such grants earmarked for scholarships and fellowships. Unrestricted current funds, on the other hand, may be used as the University decides in order to achieve its goals.

The predominant source of revenues for unrestricted current funds is Commonwealth appropriations in accordance with the provisions of Act No. 2 of 1966. See "COMMONWEALTH SUPPORT OF THE UNIVERSITY." Other important revenue sources are student tuition and fees, interest on investments and revenues of dormitories, bookstores, and other auxiliary enterprises. Educational and general expenditures are mainly for faculty, administrative and other personnel salaries, but they also include expenditures for maintenance, materials and supplies and investment in plant. In addition, there are mandatory transfers from unrestricted current funds for debt service on Bonds.

The University receives Commonwealth and federal grants or appropriations for scholarships and other student aid programs. In fiscal 2005-2006, expenditures of current restricted funds for scholarships and fellowships amounted to approximately $121 million, including approximately $106 million from Pell Grants for qualified undergraduate students and approximately $15 million from Commonwealth appropriations. The University does not anticipate material reductions in Commonwealth or federal grants or appropriations in the near future.

The following table presents, for each of the five fiscal years ended June 30, 2006, the statements of revenues and expenditures of and other changes in restricted and unrestricted current funds of the University but are not presented in conformity with generally accepted accounting principles. The statements for the four fiscal years through 2004-2005 are derived from the audited financial statements of the University. The statements for fiscal year 2005-2006 are unaudited and may include estimates (rounded to the nearest thousand) for such fiscal year. Such figures are subject to adjustment upon receipt and review by the University of actual fiscal year-end results. See Appendix A for the audited financial statements for the year ended June 30, 2005 and the report thereon, dated October 31, 2005, of Ernst & Young LLP.

Historical Statements of Current Funds Revenues, Expenditures and Other Charges

	Fiscal Year Ended June 30, 2002			Fiscal Year Ended June 30, 2003		
	Unrestricted	Restricted	Total	Unrestricted	Restricted	Total
Revenues:		(in thousands)			(in thousands)	
Tuition and fees	$ 61,918	$ 7,186	$ 69,104	$ 60,643	$ 8,052	$ 68,695
Commonwealth of Puerto Rico appropriations, grants and contracts	664,767	32,110	698,877	691,466	30,454	721,920
Federal grants and contracts	-	196,377	196,377	-	226,325	226,325
Private gifts, grants and contracts	-	13,612	13,612	-	13,748	13,748
Patient services revenue	-	47,079	47,079	-	53,329	53,329
Sales and services of educational department	890	2,422	3,312	875	2,399	3,274
Sales and services of auxiliary enterprises	6,373	-	6,373	6,657	-	6,657
Investment income	2,372	395	2,767	1,525	494	2,019
Other sources	6,240	4,917	11,157	5,276	5,833	11,100
Total current revenues	742,560	304,098	1,046,658	766,442	340,634	1,107,076
Expenditures and mandatory transfers:						
Educational and general:						
Instruction	275,561	30,172	305,733	289,721	34,203	323,924
Research	20,583	74,080	94,663	21,187	86,906	108,093
Public service	14,950	26,959	41,909	15,679	30,064	45,743
Academic support	73,843	5,681	79,524	74,115	6,630	80,745
Student services	36,596	3,062	39,658	37,890	3,627	41,517
Institutional support	126,771	4,478	131,249	127,090	6,515	133,605
Operation and maintenance of plant	88,889	270	89,159	96,744	431	97,175
Scholarships and fellowships	1,594	142,845	144,439	1,703	157,948	159,651
Hospitals	-	43,986	43,986	-	41,427	41,427
Independent operations	19	1,440	1,459	-	1,567	1,567
Other deductions	9,557	7,268	16,825	10,867	3,352	14,219
Subtotal educational expenditures	648,363	340,241	988,604	674,996	372,670	1,047,666
Mandatory transfers:						
Principal and interest	43,472	-	43,472	42,317	-	42,317
Restricted current fund matching transfers	8,418	(8,418)	-	9,840	(9,840)	-
Subtotal educational and general	700,253	331,823	1,032,076	727,153	362,830	1,089,983
Auxiliary enterprises-expenditures	8,906	-	8,906	8,633	-	8,633
Total expenditures and mandatory transfers	709,159	331,823	1,040,982	735,786	362,830	1,098,616
Excess of revenues over expenditures and mandatory transfers	33,401	(27,725)	5,676	30,656	(22,196)	8,460
Other transfers and additions/(deductions):						
Refunded to grantors	-	(294)	(294)	-	(579)	(579)
Non-mandatory transfers	(31,164)	25,766	(5,398)	(33,280)	33,736	456
Net increase/(decrease) in fund balances	$ 2,237	$ (2,253)	$ (17)	$ (2,624)	$ 10,961	$ 8,337

Fiscal Year Ended June 30, 2004			Fiscal Year Ended June 30, 2005			Fiscal Year Ended June 30, 2006 (unaudited)		
Unrestricted	Restricted	Total	Unrestricted	Restricted	Total	Unrestricted	Restricted	Total
	(in thousands)			(in thousands)			(in thousands)	
$ 60,540	$ 9,196	$ 69,736	$ 58,815	$ 6,958	$ 65,773	$ 79,929	$ 7,764	$ 87,693
728,780	35,417	764,197	778,448	45,080	823,528	835,083	42,304	877,387
-	238,622	238,622	-	238,220	238,220	-	224,460	224,460
1	17,188	17,190	-	17,916	17,916	-	19,416	19,416
-	53,566	53,566	-	54,047	54,047	-	55,047	55,047
1,071	3,556	4,628	1,040	4,786	5,826	962	5,718	6,679
6,924	-	6,924	6,992	-	6,992	7,195	-	7,195
812	632	1,444	957	932	1,889	2,794	1,360	4,154
9,189	5,930	15,119	9,213	5,682	14,895	4,354	6,116	10,471
807,319	364,107	1,171,426	855,465	373,621	1,229,086	930,318	362,184	1,292,502
309,316	37,128	346,444	330,227	45,815	376,042	345,411	40,866	386,277
21,991	91,099	113,090	23,561	99,850	123,411	26,543	95,211	121,754
16,347	33,572	49,919	19,168	38,311	57,479	20,683	40,554	61,237
76,382	8,733	85,115	80,797	9,026	89,823	87,106	8,744	95,850
41,077	3,722	44,799	42,619	3,206	45,825	44,369	3,045	47,413
134,387	8,329	142,716	141,742	6,480	148,222	159,324	9,342	168,667
97,702	430	98,132	102,293	388	102,681	122,592	394	122,986
1,691	157,066	158,757	1,628	151,716	153,344	1,548	144,991	146,540
-	48,549	48,549	-	42,760	42,760	-	47,480	47,480
-	1,582	1,582	-	-	-	-	58	58
22,002	17,457	39,459	42,143	20,248	62,391	16,910	9,992	26,902
720,895	407,667	1,128,562	784,178	417,800	1,201,978	824,486	400,679	1,225,166
43,593	-	43,593	34,717	-	34,717	36,281	-	36,281
8,725	(8,696)	29	9,626	(9,426)	200	8,959	(8,959)	-
773,213	398,971	1,172,184	828,521	408,374	1,236,895	869,727	391,720	1,261,447
10,295	-	10,295	10,555	-	10,555	10,692	-	10,692
783,508	398,971	1,182,479	839,076	408,374	1,247,450	880,419	391,720	1,272,139
23,811	(34,864)	(11,053)	16,389	(34,753)	(18,364)	49,899	(29,536)	20,363
-	(2,855)	(2,855)	-	(666)	(666)	-	(422)	(422)
(33,712)	34,147	435	(35,675)	32,140	(3,535)	(42,980)	35,971	(7,010)
$ (9,901)	$ (3,572)	$ (13,473)	$ (19,286)	$ (3,279)	$ (22,565)	$ 6,919	$ 6,013	$ 12,932

Management Discussion and Analysis

The financial information for 2005-2006 is currently being audited, and the numbers shown are subject to change. During fiscal year 2005-2006, the Unrestricted Fund experienced a net increase of $6.9 million. Revenues to the Unrestricted Fund increased by $74.8 million or 8.7%, as a result of a $68.6 million increase according to the University's funding formula under Act No. 2 of 1966 in Commonwealth appropriations and a $21.1 million increase in revenues from tuition and fees on account of the recently implemented tuition increase. (See "TUITION," above). Expenditures and transfers from the Unrestricted Fund increased by $41.3 million, or 4.9%, mainly as a result of increases in salaries, fringe benefits, equipment, travel and grants. Revenues to the Restricted Fund decreased by $11.4 million or 3.1%, mainly as a result of decreases in Federal grants. Expenditures and transfers from the Restricted Fund decreased by $16.7 million, or 4.1%, mainly as a result of decreases in scholarships and fellowships and other deductions.

During fiscal year 2004-2005, the Unrestricted Fund suffered a net decrease of $19.3 million attributable mainly to an increase the University's liability with respect to fringe benefits due to its employees (compensation for accumulated vacation time) and an increase in the legal reserve of $6.7 million. Revenues to the Unrestricted Fund during such fiscal year increased by $48.1 million, or 6%, as a result of a $10.7 million increase according to the University's funding formula under Act No. 2 of 1966 in Commonwealth appropriations. Expenditures and transfers from the Unrestricted Fund increased by $55.6 million or 7.1%, mainly as a result of increases in salaries, fringe benefits, equipment, travel and grants. The Restricted Fund suffered a net decrease of $3.3 million. Revenues to the Restricted Fund increased by $9.5 million or 2.6%. This increase was a result mainly of a $9.7 million increase in Commonwealth grants and contracts. Expenditures and transfers increased by $9.4 million or 2.4%, mainly as a result of increases in salaries, fringe benefits, equipment, travel and grants.

During fiscal year 2003-2004, the Unrestricted Fund experienced a net decrease of $9.9 million. Revenues to the Unrestricted Fund increased by $40.8 million or 5.3%, as a result of (i) an increase of $37.3 million according to the University's funding formula under Act No. 2 of 1966 in Commonwealth appropriations; and (ii) a $4.0 million increase in revenues from other sources. Expenditures and transfers from the University Fund increased by $47.7 million or 6.5%, mainly as a result of increases in salaries, fringe benefits, equipment, travel and grants. The Restricted Fund suffered a net decrease of $3.6 million. Revenues to the Restricted Fund increased by $23.5 million or 6.9%. Expenditures and transfers from the Restricted Fund increased by $36.1 million, or 10.0%, mainly as a result of increases in salaries, fringe benefits, equipment, travel and grants.

During fiscal year 2002-2003, the Unrestricted Fund decreased by $2.6 million. Revenues to the Unrestricted Fund increased by $23.9 million, or 3.3%, as a result of a $19.2 million increase according to the University's funding formula under Act No. 2 of 1966 in Commonwealth appropriations. Expenditures and transfers increased by $26.6 million or 3.8% mainly due to increases in salaries, fringe benefits, equipment , travel and grants. The Restricted Fund increased by $11.0 million. Revenues to the Restricted Fund increased by $36.5 million, or 12.0%, as a result of increases in Federal grants and contracts totaling $29.9 million and patient services of $6.3 million. Expenditures and Transfers from the Restricted Fund increased by $31.0 million or 9.3%, attributable to increases in salaries, fringe benefits, equipment, travel and grants.

Pension Plan

The University of Puerto Rico Retirement System (the "Retirement System"), a separate trust fund, administers a pension plan which provides retirement and death benefits for all employees. The fund is financed by fixed contributions by the University and the employees and by income from invested reserves. As of June 30, 2005, the date of the most recent actuarial valuation, the actuarial present value of accumulated plan benefits of the Retirement System was $820,501,000 and the actuarially computed unfunded accrued liability was $1,027,674,710.

In 1996, the University adopted Statement No. 27 of the Governmental Accounting Standards Board, "Accounting for Pensions by State and Local Governmental Employers" ("GASB No. 27"). Such adoption of GASB No. 27 was applied retroactively to July 1, 1994. GASB No. 27 establishes the measurement, recognition and disclosure of pension expenditures and related liabilities for governmental employers.

Although the University is supposed to contribute to the fund at an actuarially determined rate, which was determined to be 18.4% and 16.2% of total payroll as of June 30, 2005 and 2004, respectively, it actually contributed 15% and 14% of total payroll during those respective fiscal years 2005 and 2004. The University has continued to contribute 15% of total payroll as of June 30, 2006. The actuarially determined rate for that year was 11.3%.

PLEDGED REVENUES AND COVERAGE

Historical

The following table presents the Pledged Revenues plus Reserve Account investment earnings for the five fiscal years ended June 30, 2006, and the ratio of such amounts to Principal and Interest Requirements for the Bonds and other indebtedness of the University.

HISTORICAL REVENUES AND DEBT SERVICE COVERAGE

	Fiscal Year Ended June 30				
	2002	**2003**	**2004**	**2005**	**2006[1]**
	(dollars in thousands)				
Tuition and Other Fees	$ 57,171	$ 55,266	$ 55,431	$ 53,791	$ 73,196
Student Fees	4,748	5,378	5,109	5,024	6,733
Facility Rental and Bookstore	1,630	2,393	1,665	1,862	2,332
Interest Income[2]	2,273	1,525	812	957	2,794
Research Overhead Allowance	11,537	12,970	15,317	16,733	15,272
Other Income[3]	2,909	27,211	28,502	28,606	28,235
Subtotal	80,268	104,743	106,836	106,973	128,562
Reserve Account Interest	1,198	519	377	847	1,239
Total Pledged Revenues plus Interest	$ 81,466	$ 105,262	$ 107,213	$ 107,820	$ 129,801
Principal and Interest Requirements	$ 43,184	$ 43,175	$ 43,183	$ 38,070	$ 38,064
Senior Debt Service Coverage Ratio[4]	1.89	2.44	2.48	2.83	3.41
Plaza Universitaria Lease (Subordinate to Bonds)	4,406	4,406	5,701	5,701	5,702
Aggregate Debt Service	$ 47,590	$ 47,581	$ 48,884	$ 43,771	$ 43,766
Total Debt Service Coverage Ratio	1.71	2.21	2.19	2.46	2.97

(1) Unaudited.
(2) During 2001-2002 the average cash invested was $98.3 million at 5.90% and during 2004-2005 the average cash invested was $50.7 million at 2.32%.
(3) Commencing in fiscal year 2002-2003, includes $25 million provided annually by the Commonwealth to the University by a transfer mechanism outside of Act No. 2 of 1966. These funds, which are derived from a tax on certain gambling revenues, had been previously eliminated through Act 138 of July 1, 1999 (Educational Opportunity Law).
(4) Ratio of Total Pledged Revenues plus interest earned on Reserve Account to Principal and Interest Requirements for the University's Bonds.

Projected

The following table presents the University's estimates of Pledged Revenues plus interest earned on the Reserve Account for each of the four fiscal years ending June 30, 2010, and the ratio of such projected amounts to Principal and Interest Requirements on the Bonds and other indebtedness of the University.

The University has assumed that revenues from tuition fees will remain close to current levels, consistent with projected enrollment. See "UNIVERSITY OF PUERTO RICO - Student Enrollment." Projected Principal and Interest Requirements reflect the issuance of the 2006 Bonds. See "CAPITAL IMPROVEMENTS PROGRAM - Projected."

The estimates shown below are subject to periodic review and may be adjusted to reflect changes in interest rates, economic conditions in Puerto Rico and other factors. There can be no assurance that the Pledged Revenues actually received will not be lower than those shown below.

PROJECTED REVENUES AND DEBT SERVICE COVERAGE

	Fiscal Year Ended June 30			
	2007	**2008**	**2009**	**2010**
	(dollars in thousands)			
Tuition Fees and Other Fees	$ 77,502	$ 77,502	$ 77,502	$ 77,502
Student Fees	7,200	7,200	7,200	7,200
Facility Rental and Bookstore	2,000	2,000	2,000	2,000
Interest Income(1)	2,000	2,060	2,122	2,207
Research Overhead Allowance	15,000	15,500	16,000	16,500
Other Income	28,600	28,650	28,700	28,700
Subtotal	132,302	132,912	133,524	134,109
Reserve Account Interest	1,050	1,100	1,150	1,200
Total Pledged Revenues plus Interest	$ 133,352	$ 134,012	$ 134,674	$ 135,309
Principal and Interest Requirements(2)	$ 38,348	$ 49,068	$ 49,672	$ 48,473
Senior Debt Service Coverage Ratio(3)	3.48	2.73	2.71	2.79
Plaza Universitaria Lease:				
(Subordinate to Bonds)	5,701	5,702	5,702	5,702
Aggregate Debt Service	$ 44,049	$ 54,770	$ 55,374	$ 54,175
Total Debt Service Coverage Ratio	3.03	2.45	2.43	2.50

(1) Represents earnings on investment of funds, excluding the Construction Fund and the Sinking Fund (each as defined under the Trust Agreement).
(2) Consists of Principal and Interest Requirements for the University's outstanding Bonds, including the 2006 Bonds.
(3) Ratio of Total Pledged Revenues plus interest earned on Reserve Account to Principal and Interest Requirements for the University's Bonds, including the 2006 Bonds.

COMMONWEALTH SUPPORT OF THE UNIVERSITY

The University receives a high level of financial support from the Commonwealth for operating purposes. The source of such support is Act No. 2 of 1966. Under Act No. 2 of 1966, the Commonwealth currently appropriates to the University an amount equal to 9.6% of the average total amount of annual General Fund revenues collected under the laws of Puerto Rico in the two fiscal years immediately preceding the current fiscal year. The 9.6% level will continue unless the Commonwealth of Puerto Rico determines otherwise (through the fiscal year ended June 30, 1996, the percentage had been 9.33% and through the fiscal year ended June 30,1993 the percentage had been 9.00%). See "PUERTO RICO TAXES, OTHER REVENUES AND EXPENDITURES" in the Commonwealth Report. In addition, the Commonwealth has in recent years appropriated additional restricted funds for loans and financial assistance to students.

Act 36 of 2005 restored previous sources of funding to the University and assigned 45.45% of the income received by the Commonwealth under the Gambling Law to the University. Additionally, the Commonwealth, through Joint Resolution #159, assigned an additional $15 million to the University for student financial aid for fiscal year 2006-2007.

The following table shows the appropriations to the University from the Commonwealth (including Act No. 2 of 1966 appropriations) in each of the five fiscal years ended June 30, 2006, and the amounts estimated to be appropriated in the fiscal years ending June 30, 2008, 2009 and 2010.

COMMONWEALTH APPROPRIATIONS

Fiscal Year Ended June 30	Act No. 2 Appropriations	Other Appropriations	Total Appropriations
Actual			
2002-2003	$651,466,000	$40,000,000	$691,466,000
2003-2004	672,780,000	56,000,000	728,780,000
2004-2005	683,448,000	95,000,000	778,448,000
2005-2006	752,000,000	83,000,000	835,000,000
Estimated (1)			
2006-2007	789,000,000	89,000,000	878,000,000
2007-2008	820,000,000	95,000,000	915,000,000
2008-2009	854,000,000	102,000,000	956,000,000
2009-2010	870,000,000	110,000,000	980,000,000

(1) Expected to be appropriated under Act No. 2 of 1966 and other appropriations.

In addition to the amounts shown above, the Commonwealth of Puerto Rico from time to time appropriate funds for specific capital improvements for the University. See "CAPITAL IMPROVEMENTS PROGRAM," below.

CAPITAL IMPROVEMENTS PROGRAM

Historical

Major capital improvements projects completed during the five-year period ended June 30, 2005 include: (i) a new $4.4 million, three-story, 33,930 square-foot Botanical Gardens, University Press and Newspaper Building located at the University's Central Administration site; (ii) a new $25 million, four-story, Chemistry Building at the Mayagüez Campus, housing classrooms, research 1aboratories, offices and student services; (iii) several new facilities in Bayamón, including a $5.6 million, two-story, 52,000 square-foot Library Building, a $2.2 million, 16,000 square-foot Sports Center with capacity for 550 persons, and a $600,000 Field Track; (iv) new facilities in Carolina, including a $6.1 million, three-story, Laboratory Building for the study of secretarial sciences, biology, chemistry, and physics, and a $3.2 million, 25,000 square-foot, two-story Operations and Maintenance Building and Automobile Technology Building; (v) a new $5 million, two-story Library Building in Arecibo, accommodating student services, an audio-visual laboratory and administrative offices; (vi) a new $8 million, 85,000 square foot, three-story Library Building in Humacao, which, in addition to a traditional library, houses computer and communications laboratories; (vi) a new $29 million School of Architecture at the Rio Piedras Campus, which includes an auditorium, design workshops, library, classrooms, historical archives, a study area for students, administrative spaces, faculty offices and the School of Fine Arts; (vii) restoration of the Rio Piedras Campus Theater so it can offer a of full range of theatrical and musical representations for the next three or four decades; and (viii) a new $4.5 million School of Social Work building, a three-story structure with classrooms, a library, administrative space and study areas.

The following table summarizes the capital improvements of the University and their funding sources for the five fiscal years ended June 30, 2006.

HISTORICAL CAPITAL IMPROVEMENTS PROGRAM

	Fiscal Year Ended June 30					
	2002	2003	2004	2005	2006	Total
	(in thousands)					
Capital Improvements:[1]						
Central Administration	$ 16,328	$ 6,914	$ 20,021	$ 5,031	$ 2,964	$ 51,258
Río Piedras Campus	17,306	8,748	4,345	11,712	12,938	55,049
Mayagüez Campus	11,169	11,012	9,781	9,586	4,652	46,200
Medical Sciences	708	347	421	5,688	3,186	10,350
University of Puerto						
Aguadilla	107	5	20	870	852	1,854
Arecibo	195	221	179	455	223	1,273
Bayamón	275	113	130	5,752	1,385	7,655
Carolina	370	59	92	532	710	1,763
Cayey	1,585	1,081	1,460	3,023	6,962	14,111
Humacao	1,427	603	348	927	2,829	6,134
Ponce	290	14	5	175	415	899
Utuado	180	22	7	1,540	4,360	6,109
Total	$ 49,940	$ 29,139	$ 36,809	$ 45,291	$ 41,476	$ 202,655

Sources of funds:						
Internally generated funds[2]	$ 533	$ 222	$ 595	-	$ 651	$ 2,001
Grants:						
Commonwealth grants[3]	3,767	1,858	5,286	6,880	9,362	27,153
Federal grants	243	483	438	-	2,349	3,513
Insurance proceeds	4	-	194	-	734	932
Private Contributions	37	3	7	-	-	47
Borrowed funds and line of credit[4]	45,356	26,573	30,289	38,411	28,380	169,009
Total	$ 49,940	$ 29,139	$ 36,809	$ 45,291	$ 41,476	$ 202,655

(1) Excluding expenditures of current funds for the normal replacement of movable equipment and library books, as well as interest during construction, but including major repairs and extraordinary maintenance.

(2) Used for major repairs and extraordinary maintenance.

(3) Includes grants from the Commonwealth, municipalities and other governmental entities or instrumentalities of Puerto Rico.

(4) Includes proceeds from the sale of the University's Series M and Series O Bonds and monies borrowed under a Government Development Bank line of credit.

Projected

The Capital Improvements Program of the University for the four-year period from July 1, 2006 to June 30, 2010 includes the construction of new facilities, the renovation and rehabilitation of existing structures and the development of infrastructure.

The University's master development plan (the "Master Plan"), which was commissioned by the President of the University and its Chancellors and is subject to Board approval, is a blueprint designed to direct the future growth of, and to establish organizational and design principles for, each of the University's campuses. It reviews existing facilities, determines types of uses to be developed, and provides phasing and implementation strategies for the future. The Master Plan serves as a roadmap for the Capital Improvements Program; any exceptions to the Master Plan are subject to approval by the Board. As of the date of this Official Statement, the Master Plan has been completed and approved by the Board.

The following table organizes the planed capital improvements and the estimated sources of funds for such improvement for the fiscal year ending June 30, 2010.

PROJECTED CAPITAL IMPROVEMENTS PROGRAM

	Fiscal Year Ended June 30				
	2007	2008	2009	2010	Total
			(in thousands)		
Capital Improvements[(1)]					
Central Administration	$ 20,577	$ 4,656	$ 4,400	$ 3,848	$ 33,481
Río Piedras Campus	11,783	12,145	12,611	4,887	41,426
Mayagüez Campus	9,648	7,478	9,499	8,382	35,006
Medical Sciences Campus	7,351	12,415	5,945	5,160	30,872
University of Puerto Rico at					
Aguadilla	3,677	1,387	-	-	5,064
Arecibo	1,114	1,281	600	-	2,995
Bayamón	2,997	6,159	6,000	3,112	18,268
Carolina	1,315	1,062	1,210	-	3,587
Cayey	3,755	3,868	320	-	7,943
Humacao	2,374	845	-	-	3,219
Ponce	962	-	-	-	962
Utuado	1,093	1,160	-	-	2,253
Total	**$ 66,646**	**$ 52,456**	**$ 40,586**	**$ 25,390**	**$ 185,077**
Sources of funds					
Grants:					
Internally generated funds[(2)]	$ 3,586	-	-	-	$ 3,586
Commonwealth grants[(3)]	3,440	3,627	1,900	1,900	10,866
Federal grants	1,491	252	-	-	1,743
Insurance proceeds	749	-	-	-	749
Private Contributions	-	-	-	-	-
Borrowed funds	57,380	48,577	38,686	23,490	168,133
Total	**$ 66,646**	**$ 52,456**	**$ 40,586**	**$ 25,390**	**$ 185,077**

(1) Excluding expenditures of current funds for the normal replacement of movable equipment and library books, as well as interest during construction, but including major repairs and extraordinary maintenance.

(2) Used for major repairs and extraordinary maintenance.

(3) Includes grants from Puerto Rico municipalities and other governmental entities or instrumentalities of Puerto Rico.

Included in the table are ongoing and new projects having various completion dates. Among the eleven units there are approximately thirty projects included in the Capital Improvements Program, which projects include renovations, upgrading, expansion or building of new facilities. The following are examples of some of the major projects being undertaken by the University:

Molecular Sciences Building

The Molecular Sciences Building is the most significant project of the Capital Improvements Program. With a structure consisting of approximately 153,000 square feet, it will enhance the research capabilities of the University. This $45 million investment is a joint project between the Medical Sciences and the Río Piedras campuses. It will be located in the Knowledge Corridor that links the Medical Sciences Campus, the Botanical Gardens and the Río Piedras Campus, connected by the new Urban Train. The Molecular Sciences Building is scheduled to be completed by 2008.

Seismic Network Center

The Mayagüez Campus houses the Puerto Rico Seismic Network as part of its Geology Department. Its mission is to detect, process and research seismic activity in the region. It must report its findings for public security purposes, education and engineering research. A new 12,000 square foot Seismic Network Center is being designed. This $4 million investment will be co-financed by the Capital Improvements Program and external funds. The expected completion date for this project is March 2007.

Biopharmaceutical and Bioprocess Plant

In a combined effort with Puerto Rico Industrial Development Company ("PRIDCO"), the Mayagüez Campus is constructing a $4.5 million off-campus Biopharmaceutical and Bioprocess Plant. This 30,000 square foot structure is a two-story building dedicated to researching the improvement of biotechnological processes. The facilities will have teaching laboratories and will provide the undergraduate and graduate students with the opportunity to interact with researchers and engineers from the private sector.

Technology, Sciences and Faculty Offices Complex

The University at Bayamón is designing facilities for the natural sciences and technology programs and faculty offices, including state of the art science laboratories. Construction began during the first semester of academic year 2006-2007.

SUMMARY OF CERTAIN PROVISIONS OF THE TRUST AGREEMENT

The following statements are brief summaries of certain provisions of the Trust Agreement. Said statements do not purport to be complete and reference is made to the Trust Agreement, copies of which are available for examination at the offices of the Director of Finance of the University, the Trustee and the Co-Trustee. All terms used within this summary section and not otherwise defined shall have the meanings assigned to them in the Trust Agreement.

Establishment of Funds and Accounts

The Trust Agreement provides for the establishment of the Construction Fund to be held by the Co-Trustee or by the University with a qualified national banking association, bank or trust company other than the Co-Trustee (Section 401) and the Sinking Fund, comprised of the Bond Service Account, Reserve Account and Redemption Account to be held and maintained by the Trustee. (Section 503).

Application of Revenues

The Trust Agreement defines Pledged Revenues as the proceeds, receipts, profits and other income derived or to be derived by or on behalf of the University from:

(i) tuition fees collected from all students of the University;

(ii) student fees collected from all students of the University;

(iii) rentals and other charges received for the right of use or occupancy of the facilities in the University System;

(iv) bookstore receipts (gross sales less cost of books and supplies sold);

(v) interest on investment of University funds excluding the Construction Fund;

(vi) funds paid to the University in respect of overhead allowances on Federal research projects;

(vii) income from all other sources excluding clauses (i) though (vi) and (viii) of this paragraph and other than appropriations and contributions; and

(viii) amounts received by the University through any debt service grant programs of the United States Government or any agency thereof. (Section 101).

The Pledged Revenues (excluding any amounts received under any debt service grant program of the United States Government or any agency thereof) shall be collected by the University and deposited as received with the Trustee. (Section 503). In the Trust Agreement the University covenants to fix, impose, revise from time to time and collect such tuition fees, student fees and rentals and other charges for the right of use or occupancy of the University System, so that the Pledged Revenues (after deducting amounts received under such debt service grant programs), together with any other funds, including funds appropriated by the Commonwealth of Puerto Rico, available for the payment of principal of and interest on the bonds, will at all times be sufficient to make the deposits to the credit of the Sinking Fund for the Bond Service Account, the Redemption Account and the Reserve Account as required under the provisions of the Trust Agreement. (Section 501).

The Trustee shall, upon the receipt of the Pledged Revenues, make deposits to the credit of the following accounts in the amounts specified and in the following order:

(a) the Bond Service Account, until an amount equal to the interest then due or the interest which shall become due within the next ensuing 6 months on all bonds then outstanding and an amount equal to the principal of all serial bonds, if any, then due or which shall become due within the next ensuing 12 months, has been accumulated;

(b) the Redemption Account, the amount of the Amortization Requirements as defined in the Trust Agreement, if any, for the fiscal year in which such deposit is made for the term bonds of each series then outstanding, plus the premiums, if any, on the principal amount of term bonds which would be payable in such fiscal year if such bonds were redeemed prior to their maturities from Sinking Fund monies; and

(c) the Reserve Account, until the balance therein is equal to the maximum aggregate Principal and Interest Requirements for any fiscal year thereafter on account of all bonds then outstanding (the additional requirement for additional series of bonds need not exceed 20% of the amount of the increase in such maximum aggregate Principal and Interest Requirements resulting from the issuance of the bonds of such series in any fiscal year).

For bonds bearing interest at a variable rate, the amount to be deposited in the Bond Service Account shall be the amount of interest on such bonds estimated to be due and payable on the bonds for the next ensuing six months, which interest shall be based initially on the interest rate in effect on the date of issuance and then shall be adjusted monthly based on the actual interest accrued to the date of adjustment; and for capital appreciation bonds, the amount payable at maturity shall be treated as a maturing installment of principal of a serial bond (special rules are also provided for balloon bonds). If the principal of or interest or premium, if any, on any bond is paid by a credit or liquidity facility, the amounts deposited in the Bond Service Account and the Redemption Account allocable to said bond shall be paid to the provider of such letter of credit or similar credit or liquidity facility.

Any balance remaining after making the deposits under (a), (b) and (c) above shall be deposited by the Trustee as directed by the Director of Finance of the University and may be used for any lawful purpose. The requirements specified in (a), (b) and (c) above shall be cumulative. The Trust Agreement provides the following rules in determining the amount of the Principal and Interest Requirements:

(a) the interest rate on bonds bearing interest at a variable rate shall be the interest accrued on such bonds for such fiscal year; provided, however, that for purposes of determining the Principal and Interest Requirements under the projected tests for the issuance of additional bonds and transfers of certain property and for purposes of determining the maximum Principal and Interest Requirements for any fiscal year in order to determine the required deposit to the Reserve Account, the interest on such bonds shall be assumed to be the greater of (A) one hundred ten percent (110%) of the average interest rate on such bonds during the twelve months ending with the month preceding the date of calculation or such shorter period that such Variable Rate Bonds shall have been outstanding, and (B) the actual rate of interest on such bonds on the date of calculation; provided that if such bonds had not been outstanding prior to the date of calculation, for purposes of the test set forth in clause (A) above there shall be substituted the average interest rate for comparable securities for such twelve-month period, as certified by an underwriting or investment banking firm experienced in marketing such securities; and provided further that for purposes of determining the required deposit to the Reserve Account, interest on bonds bearing interest at a variable rate shall be calculated as of the first day of the fiscal year for which such calculation shall be required and on the date of issuance of any additional series of bonds during such fiscal year;

(b) in the case of bonds which may be tendered (or "put") for payment of principal and interest prior to maturity by their holders, the "put" date shall be ignored if said "put" is payable from monies drawn under a letter of credit or similar credit facility or liquidity facility, and the stated fiscal years for Amortization Requirements and stated dates for principal payments shall be used, and in the case of bonds secured by a letter of credit or similar credit facility or liquidity facility, the terms of the reimbursement obligation to the providers thereof shall be ignored and the stated fiscal years for Amortization Requirements and the stated dates for principal payments shall be used, unless the provider of the letter of credit or similar credit facility or liquidity facility has advanced funds thereunder and such amount has not been repaid, in which case Principal and Interest Requirements shall include the repayment obligation thereof in lieu of the stated terms of the bonds secured thereby, in accordance with the principal repayment schedule and interest rate or rates specified in the documents relating to such letter of credit or similar credit facility or liquidity facility, if the repayment obligation is secured on a parity with the bonds;

(c) in the case of bonds whose maturity date or dates may be extended by the holders or the University, the bonds shall be deemed to mature on the later of the stated maturity date and the date to which such stated maturity date has been extended;

(d) in the case of Capital Appreciation Bonds, the principal and interest portions of the Accreted Value thereof shall be included on the date such bonds are payable, either at maturity or by virtue of an Amortization Requirement;

(e) in the case of Capital Appreciation and Income Bonds, the principal and interest portions of the Appreciated Value thereof shall be included on the date such bonds are payable, either at maturity or by virtue of an Amortization Requirement;

(f) in the case of Balloon Bonds, the amounts required to pay the stated principal and interest thereon shall be ignored and in lieu thereof there shall be included the amounts required to pay principal and interest on debt securities of equal aggregate principal amount and having a comparable federal tax status as such Balloon Bonds, maturing in substantially equal annual payments of principal and interest over a period of not more than 30 years from the date of issuance thereof, bearing a fixed interest rate equal to the average interest rate per annum for debt securities on the date of issuance of such Bonds issued by issuers having a credit rating, issued by Moody's or any successors thereto and S&P or any successors thereto comparable to that of the University, as shown by a certificate of an underwriting or investment banking firm experienced in marketing such securities; provided that for a Balloon Bond outstanding on any date of calculation which date is (i) more than one but not more than three years before the maturity of such Balloon Bond, the principal of such Balloon Bond shall be treated as being amortized in equal annual installments over such period and (II) not more than one year before the maturity of such Balloon Bond, the full principal of such Balloon Bonds shall be included; and

(g) if all or a portion of the principal of or interest on a series of bonds is payable from funds, or Commonwealth Obligations, the principal of and interest on which when due will provide funds, irrevocably set aside or deposited for such purpose, such principal or interest shall not be included in determining Principal and Interest Requirements; provided that the sufficiency of such funds for such purpose shall be supported by a verification report prepared by a firm of independent certified public accountants selected by the University.

The Trust Agreement defines:

"Accreted Value" with respect to any Capital Appreciation Bond or Capital Appreciation and Income Bond as an amount equal to the principal amount of such bond on the date of original issuance plus the interest accrued thereon from the date of original issuance to the date of calculation or the Interest Commencement Date, as the case may be compounded on the dates and at the rate provided for in the resolution authorizing the issuance of such bond.

"Appreciated Value" as with respect to any Capital Appreciation and Income Bond (i) up to and including the Interest Commencement Date, the Accreted Value, and (ii) after the Interest Commencement Date, the Appreciated Value on the Interest Commencement Date.

"Balloon Bonds" as any bonds of a series, (a) the interest on which is payable periodically, (b) which matures at least ten years after the date of issuance and after any other bonds of such series, (c) the original principal amount of which constitutes at least twenty-five percent (25%) of the original principal amount of all bonds of such series and (d) for which maturing principal amount amortization requirements have not been designated.

"Capital Appreciation Bonds" as any bonds the interest on which is compounded periodically on the dates designated in the resolution authorizing such bonds and is payable in an amount equal to the then current Accreted Value only at maturity, earlier redemption or other payment date therefor, all as so designated in such resolution. For the purposes of (i) receiving payment of the redemption price if a Capital Appreciation Bond is redeemed prior to maturity to the extent provided in the resolution authorizing the Capital Appreciation Bonds, or (ii) receiving payment of a Capital Appreciation Bond if the principal of all bonds is declared immediately due and payable following an event of default as provided in the Trust Agreement, or (iii) computing the principal amount of bonds held by the registered owner thereof in giving to the University or the Trustee any notice, consent, request, or demand pursuant to the Trust Agreement for any purpose whatsoever, the principal amount of a Capital Appreciation Bond shall be deemed to be its Accreted Value and the principal amount of a Capital Appreciation and Income Bond shall be deemed to be its Appreciated Value.

"Capital Appreciation and Income Bonds" as any bonds the interest on which is not paid prior to the Interest Commencement Date specified in the resolution authorizing the issuance of such bonds and is compounded periodically on the dates designated in such resolution prior to such Interest Commencement Date, and which may be serial bonds or term bonds. (Section 503).

Monies in the Bond Service Account shall be used only for payment of principal on the serial bonds and interest on all bonds. (Section 504). Monies in the Reserve Account shall first be used for the payment of interest on the bonds and maturing principal of the bonds whenever monies in the Bond Service Account are insufficient and thereafter for the purpose of making the deposits to the credit of the Redemption Account on account of the Amortization Requirements for the term bonds for the then current or any previous fiscal year whenever and to the extent that the Pledged Revenues are insufficient for such purpose.

The University may deposit into the Reserve Account at any time a Reserve Account Insurance Policy or Reserve Account Letter of Credit in lieu of any required deposit into the Reserve Account. Said Reserve Account Insurance Policy or Reserve Account Letter of Credit may be secured by a lien on Pledged Revenues not inconsistent with the provisions of the Trust Agreement. If a disbursement is made under any Reserve Account Insurance Policy or Reserve Account Letter of Credit, the University shall be obligated either to reinstate the limits of such Reserve Account Insurance Policy or Reserve Account Letter of Credit or to deposit into the Reserve Account monies or Investment Obligations in accordance with the provisions contained in the Trust Agreement in the amount of such disbursement. Prior to the expiration date of any Reserve Account Insurance Policy or Reserve Account Letter of Credit the University is required to cause the term of such Reserve Account Insurance Policy or Reserve Account Letter of Credit to be extended, or replace any such Reserve Account Insurance Policy with monies (including monies drawn thereunder) or another Reserve Account Letter of Credit or Reserve Account Insurance Policy.

The Trust Agreement defines "Reserve Account Insurance Policy" as an insurance policy, surety bond or other evidence of insurance, administratively acceptable to the Trustee, the provider of which is a municipal bond insurer whose policy, bond or other evidence of insurance results in the ratings of obligations secured thereby at the time of deposit thereof to the credit of the Reserve Account in any of the three highest rating categories (without regard to gradations within such categories) of either Moody's or any successors thereto or S&P or any successors thereto.

The Trust Agreement defines "Reserve Account Letter of Credit" as an irrevocable, transferable letter of credit, administratively acceptable to the Trustee, the provider of which is a banking association, bank or trust company or branch thereof whose letter of credit results in the rating of obligations secured by such letter of credit at the time of deposit thereof to the credit of the Reserve Account in any of the three highest rating categories (without regard to gradations within such categories) of either Moody's or any successors thereto or S&P or any successors thereto.

Excess monies held for the credit of the Reserve Account shall be transferred to the credit of the Bond Service Account. (Sections 503 and 506).

Monies deposited in the Redemption Account must be applied first to the purchase or redemption of term bonds to the extent of the Amortization Requirements and then to the purchase or redemption, on a pro rata basis, of serial bonds held by HUD, HEW and others. (Section 505).

Additional Bonds

Additional bonds maybe issued, under the conditions set forth in the Trust Agreement, for the purpose of paying all or part of the cost of certain Additional Facilities, including the repayment of monies advanced for paying such costs, and if deemed necessary by the Board, the interest to accrue on such monies advanced to the date of such payment. Prior to the issuance of additional bonds, certificates must be furnished to the Trustee showing that the lesser of the Pledged Revenues (not including any debt service grant payments of the United States Government or any agency thereof) plus Reserve Account earnings for (i) 12 consecutive months out of the 18 calendar months next preceding the issuance of such bonds (as determined by an independent certified public accountant) or (ii) 12 months following the issuance of such bonds (as estimated by the Director of Finance), is not less than 150% of the maximum aggregate Principal and Interest Requirements (defined in the Trust Agreement as the amount required in each fiscal year to pay interest on and principal (including the Amortization Requirements) of the bonds less payments under any debt service grant program of the United States Government or any agency thereof) for any fiscal year thereafter on account of the bonds at the time outstanding and such additional bonds. (Section 208). Refunding bonds may be issued, under the conditions set forth in the Trust Agreement, to refund at or prior to their respective maturities all or part of any bonds issued under the Trust Agreement or to refund bonds not issued under the Trust Agreement. (Sections 209 and 210).

Investments

Monies in the Construction Fund and the Reserve Account shall be invested in Investment Obligations (described below) and monies in the Bond Service Account and the Redemption Account shall be invested in Government Obligations (described below), all of which shall mature, or be subject to redemption at the option of the holder thereof, not later than the respective dates when monies held for the credit of said Fund or Accounts will be required for the purposes intended or as to the Reserve Account investments, not later than the final maturity date of any bonds outstanding under the Trust Agreement. In lieu of such investments, monies in any or all of such Fund or Accounts maybe placed in time deposits. (Section 602).

The Trust Agreement defines "Government Obligations" as (i) direct obligations of, or obligations the payment of the principal of and interest on which are unconditionally guaranteed by, the United States of America; (ii) municipal obligations, the payment of the principal of and interest and redemption premium, if any, on which are irrevocably secured by noncallable obligations described in clauses (i) above or (iii) below deposited in escrow and irrevocably pledged to the payment of the principal of and interest and redemption premium, if any, on such municipal obligations and which municipal obligations are rated in the highest rating category by both Moody's or any successor thereto and S&P or any successor thereto; and (iii) evidences of ownership of proportionate interests in future interest or principal payments on obligations specified in clauses (i) or (ii) above.

The Trust Agreement defines "Investment Obligations" as any of the following, to the extent that the same is legal for the investment of public funds under Puerto Rico law:

(i) Government Obligations;

(ii) obligations (including participation certificates) issued or guaranteed by an agency of the United States of America or person controlled or supervised by and acting as an instrumentality of the United States of America pursuant to authority granted by Congress, whether now existing or hereafter organized, including but not limited to those of the Federal Home Loan Mortgage Corporation, Federal Home Loan Banks, the Farm Credit System, Federal National Mortgage Association and the Student Loan Marketing Association and evidences of direct ownership of proportionate interests in future interest or principal payments in such obligations specified above;

(iii) bankers' acceptances, certificates of deposit or time deposits of a national banking association or bank (including either of the Trustees), a trust company or a savings and loan association (including any investment in pools of such bankers' acceptances, certificates of deposit or time deposits), which to the extent that such obligations are not insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, are either (A) issued by a national banking association or bank, trust company or savings and loan association having on the date of investment, a combined capital and surplus aggregating at least $50,000,000 or (B) collateralized at all times by such securities, as are described in clauses (i) or (ii) above, having a market value at least equal to the principal amount of such bankers' acceptances, certificates of deposit or time deposits (or portion thereof not so insured) provided that the Trustee or the Co-Trustee, as the case may be, has a perfected first lien security interest in the collateral and that such collateral is held free and clear of claims by third parties;

(iv) municipal obligations which are rated on the date of investment therein in one of the three highest rating categories (without regard to any gradation within such categories) by both Moody's or any successors thereto and S&P or any successors thereto;

(v) any repurchase, reverse repurchase or investment agreement with any national banking association or bank (including either of the Trustees) or any trust company, insurance company, or government bond dealer reporting to, trading with, and recognized as a primary dealer by the Federal Reserve Bank of New York and a member of the Security Investors Protection Corporation, which agreement is secured by any one or more of the securities described in (i) or (ii) above, provided that the Trustee or the Co-Trustee, as the case may be, has a perfected first lien security interest in the collateral and that such collateral is held free and clear of claims by third parties;

(vi) commercial paper which is rated or which is backed by a letter of credit or line of credit the provider of which is rated), on the date investment therein in one of the two highest rating categories (without regard to any gradation within such categories) by both Moody's or any successors thereto and S&P or any successors thereto; and

(vii) any other of obligations which are rated, on the date of investment therein, in one of the three highest rating categories (without regard to any gradation within such categories) by both Moody's or any successors thereto.

Insurance

The University shall carry or cause to be carried, with a responsible insurance company or companies, authorized and qualified under the laws of Puerto Rico to assume the risk thereof, insurance covering such properties of the University as are customarily insured, and against loss or damage from such causes as are customarily insured against, by other universities of similar size and with similar facilities. The University may institute a self-insurance program with regard to such risks as shall be consistent with the practices of universities and colleges of similar size and with similar facilities. The proceeds of such insurance, if sufficient with other available funds, shall be used to repair, replace or reconstruct the damaged or destroyed property. If the University determines that the repair, replacement or reconstruction of the property damaged is not essential to the efficient operation of the University System, such insurance proceeds shall be applied to the redemption of bonds in such manner as the University shall direct.

If the proceeds, with other available funds, are insufficient for such purpose, the University may cover such insufficiency from monies to the credit of the Construction Fund. If such proceeds and other monies exceed the amount needed for such repair, replacement or reconstruction, such excess shall be deposited with the Trustee to the credit of the Construction Fund, (Section 707).

Reports and Audits

The University covenants that, not later than six months after the close of each fiscal year, it will file with the Trustee and the Co-Trustee and mail to the registered owners of the bonds, to all other bondholders who shall file their names and addresses with the Secretary of the Council for such purpose, to the principal underwriters and to any agency of the United States of America which may at the time be a holder of any of the bonds, an audit report for the preceding fiscal year reflecting in reasonable detail the financial condition and record of operation of the University and the

University System and including (i) a balance sheet of the University for the end of such fiscal year, showing a maintenance and repair reserve in an amount approved by the accountant preparing such audit report, (ii) a statement of revenue and expenditures for such fiscal year, showing separately each item of the Pledged Revenues, and (iii) a statement as to the insurance policies then in force, the schedule of tuition fees and student fees then in effect and the status of the funds established pursuant to the Trust Agreement, each such audit report to be prepared by a certified public accountant of suitable experience and responsibility. (Section 710).

Disposition of Property by University

The University may from time to time, subject to the provisions of the Trust Agreement regarding compliance with federal education laws and other matters, permanently abandon the use of, or sell at fair market value, any part of the University System if the amount held in the Reserve Account shall be at least the required amount and the University certifies in writing that (A) it is not then in default in the performance of any of the covenants, conditions, agreements or provisions contained in the Trust Agreement, and (B) the estimated Pledged Revenues for the fiscal year next succeeding such abandonment or sale (after deducting the estimated amounts to be received in such fiscal year under any debt service subsidy program of the United States Government or agency thereof and after giving effect to such abandonment or sale and any replacement) will either (i) be not less than one hundred fifty percent (150%) of the maximum Principal and Interest Requirements for any fiscal year thereafter on account of all bonds then outstanding under the Trust Agreement, or (ii) not cause a reduction in the ratio of Pledged Revenues to Principal and Interest Requirements for any such fiscal year.

The proceeds of any such sale under the provisions of this paragraph shall either be deposited in the Redemption Account or be used to acquire or construct a facility or facilities to replace the facilities so sold, and any such replacement facility or facilities shall then become a part of the University System subject to the provisions of the Trust Agreement. (Section 711).

Remedies of Bondholders

The Trust Agreement defines events of default as failure to pay principal, redemption premium, if any, when due or any installment of interest within 30 days, failure for 30 days (or such longer period if said default cannot be cured within said thirty (30) day period and the University has exercised reasonable diligence in remedying said defaults) after written notice by the Trustee (which is required to give such notice at the written request of the holders of 10% of the aggregate principal amount of the bonds then outstanding) to perform any covenant, condition, agreement or provision contained in the bonds or the Trust Agreement, including meeting any Amortization Requirement, the University's being rendered incapable of fulfilling its obligations under the Trust Agreement, if so provided in the resolution authorizing the issuance of a particular series of bonds, the receipt of notice by the Trustee and the University that an event of default has occurred under the agreement providing for the issuance of a letter of creditor a similar credit or liquidity facility relating to any bonds or if the provider thereof has failed to make the facility available or to reinstate the interest component of the facility in accordance with its terms, the entry of a decree appointing a receiver with or without the consent or acquiescence of the University, and the institution of proceedings with the consent or acquiescence of the University for the purpose of adjusting the claims of creditors pursuant to any Federal or state statute, in each case within or for the specified period of grace, if any. (Section 802).

In the event of any default, the Trustee may on its own initiative and shall, upon satisfactory indemnification and the request of the holders of not less than 20% in aggregate principal amount of the bonds then outstanding, declare the principal of all the bonds then outstanding to be due and payable. (Section 803). In the event of any default, the Trustee may on its own initiative and shall, upon satisfactory indemnification and the request of the holders of not less than 10% in aggregate principal amount of the bonds then outstanding, proceed either at law or in equity to protect and enforce any and all rights of the Trustee and the bondholders under the laws of the Commonwealth of Puerto Rico or the Trust Agreement and may enforce and compel the performance of all duties required under the laws of the Commonwealth of Puerto Rico or the Trust Agreement to be performed by the University. (Section 804).

Modification of the Trust Agreement

The University and the Trustee and the Co-Trustee may enter into supplemental agreements to cure any ambiguity, formal defect or omission in the Trust Agreement, to grant to the Trustee or the Co-Trustee for the benefit of the bondholders any additional rights, remedies, powers, authority or security that may be lawfully granted, to add to the conditions, limitations and restrictions on the issuance of bonds under the provisions of the Trust Agreement other conditions, limitations and restrictions thereafter to be observed, to add to the covenants and agreements of the University in the Trust Agreement other covenants and agreements thereafter to be observed by the University or to surrender any right or power in the Trust Agreement reserved to or conferred upon the University. (Section 1101). The Trust Agreement may be modified, altered, amended, added to or rescinded in any particular from time to time with the consent of the holders of not less than two-thirds in the aggregate principal amount of the bonds outstanding, provided that nothing shall permit (a) an extension of the maturity of the principal of or the interest on any bonds, (b) a reduction in the principal amount of, or the redemption premium or the rate of interest on, any bond, (c) the creation of a lien upon or a pledge of the Pledged Revenues other than the lien and pledge created by the Trust Agreement, (d) a preference or priority of any bond or bonds over any other bond or bonds, or (e) a reduction in the aggregate principal amount of the bonds required for consent to such supplemental agreement. (Section 1102).

Defeasance

Any outstanding bond shall be deemed to have been paid within the meaning and with the effect expressed in the Trust Agreement when the whole amount of the principal of and interest on such bond shall have been paid or when, among other things, (a) there shall have been irrevocably deposited in escrow for the benefit of the holder of such bond either monies sufficient, or noncallable Sufficient Government Obligations (described below), verified by an independent certified public accountant, to pay when due the principal of and premium, if any, and interest due and to become due on such bond on or prior to the redemption or maturity date thereof, and (b) in the event such bond does not mature or is not to be redeemed within the next succeeding sixty (60) days, the University shall have given irrevocable instructions to give prompt notice to the holder of such bond of the deposit of monies or Sufficient Government Obligations mentioned in clause (a) of this paragraph and that such bond is deemed to have been paid in accordance with the Trust Agreement and of such maturity or redemption date upon which monies are to be available for the payment of the principal of and premium, if any, and interest on such bond.

The Trust Agreement defines "Sufficient Government Obligations" as Government Obligations or obligations issued by Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Farm Credit System, Federal Home Loan Banks or Student Loan Marketing Association that are in such principal amounts, bear interest at such rate or rates and are not subject to redemption except at the option of the holder thereof so that the proceeds to be received upon payment thereof and all interest to be received thereon, without any reinvestment thereof, will provide monies on the date required sufficient to pay the principal of and redemption premium, if any, and the interest on the bonds for the benefit of which such Sufficient Government Obligations have been deposited to the dates of their redemption or maturity. (Section 1201).

SUMMARY OF CERTAIN PROVISIONS OF PROPOSED SUPPLEMENTAL AGREEMENT

The following is a summary of certain provisions of the proposed Third Supplemental Agreement in its current form. The summary does not purport to be complete and reference is made to the proposed Third Supplemental Agreement, copies of which are available in substantially final form for examination at the corporate trust office of the Trustee and at the office of the Director of Finance of the University. The proposed Third Supplemental Agreement may be executed in part or in whole and is subject to modification prior to or after execution without further bondholders' consent to the extent such modifications would not require consent of bondholders under the provisions of the Trust Agreement after the Third Supplemental Agreement is executed. All terms used within this summary section and not otherwise defined shall have the meanings assigned to them in the Trust Agreement or the Third Supplemental Agreement, as the case may be.

Purchasers of the 2006 Bonds will have consented by their purchase to the terms of the Third Supplemental Agreement. The Third Supplemental Agreement will become effective when owners of 100% of the outstanding Bonds consent. Upon the issuance of the 2006 Bonds, the owners of 97.97% of the outstanding Bonds will have consented to the Third Supplemental Agreement.

Third Supplemental Agreement

The Trust Agreement will be supplemented to provide that the University may grant a lien on Pledged Revenues on a parity with the lien of the holders of bonds to providers of credit or liquidity facilities securing the bonds. In addition, the type of amendments to the Trust Agreement which do not require bondholders' consent will be expanded and amendments which under the Trust Agreement currently require the consent of owners of 66⅔% of the bonds outstanding will require the consent of owners of a majority of the affected bonds outstanding.

LITIGATION

There is no pending litigation of any nature restraining or enjoining or seeking to restrain or enjoin the issuance, sale or delivery of the 2006 Bonds or in any way contesting or affecting the validity of the 2006 Bonds, the resolutions or the proceedings of the University taken with respect to the authorization, issuance or sale thereof, or the pledge or application of any monies under the Trust Agreement or the existence or powers of the University.

The University is a defendant in various lawsuits arising in the normal course of its business, including contract, construction and miscellaneous claims. In the opinion of the University and its General Counsel, the ultimate disposition of such existing proceedings will not have a material adverse effect on the financial position or operations of the University.

TAX MATTERS

The Internal Revenue Code of 1986, as amended (the "Code"), includes requirements regarding the use, expenditure and investment of the proceeds of the 2006 Bonds and the timely payment of certain investment earnings to the Treasury of the United States, if required, which the University must continue to meet after the issuance of the 2006 Bonds in order that interest on the 2006 Bonds not be included in gross income for federal income tax purposes. The University's failure to meet these requirements may cause interest on the 2006 Bonds to be included in gross income for federal income tax purposes retroactive to their date of issuance. The University has covenanted to comply, to the extent permitted by the Constitution and the laws of Puerto Rico, with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the 2006 Bonds. Bond Counsel is not aware of any provision of the Constitution or laws of Puerto Rico which would prevent the University from complying with the requirements of the Code.

In the opinion of Bond Counsel, subject to continuing compliance by the University with the tax covenant referred to above, under the provisions of the Acts of Congress now in force and under existing regulations, rulings and court decisions, interest on the 2006 Bonds will not be includable in gross income for federal income tax purposes. Interest on the 2006 Bonds will not be a specific item of tax preference for the purposes of the federal alternative minimum tax imposed on individuals and corporations; however, interest on the 2006 Bonds will be includable in the computation of the alternative minimum tax on corporations imposed by the Code. Bond Counsel expresses no opinion as to the effect of any action taken or not taken after the date of its opinion without its approval (except for such action or omission to act as is provided for in the documents pertaining to the 2006 Bonds) or in reliance upon advice of counsel other than such firm on the exclusion from gross income of the interest on the 2006 Bonds for federal income tax purposes. Bond Counsel is further of the opinion that the 2006 Bonds and the interest thereon are exempt from state, Commonwealth and local income taxation.

Ownership of tax-exempt obligations may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations, certain S Corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, and taxpayers who may be eligible for the earned income tax credit. Ownership of the 2006 Bonds may also result in collateral income tax consequences under Commonwealth law to financial institutions doing business in Puerto Rico. Prospective purchasers of the 2006 Bonds should consult their tax advisors as to the applicability of any such consequences and other state, Commonwealth and local tax consequences of owning and disposing the 2006 Bonds.

Legislation affecting tax-exempt obligations is constantly being considered by the United States Congress. There can be no assurance that legislation enacted after the date of issuance of the 2006 Bonds will not have an adverse effect on the tax-exempt status of the 2006 Bonds. Legislative or regulatory actions and proposals may affect the economic value of tax exemption or the market prices of the 2006 Bonds.

Premium Bonds

The excess, if any, of the tax basis of the 2006 Bonds to a purchaser (other than a purchaser who holds such 2006 Bonds as inventory, stock in trade or for sale to customers in the ordinary course of business) who purchased such 2006 Bonds as part of the initial public offering and at the initial offering price set forth or derived from information set forth on the inside cover page over the amount payable at maturity is "bond premium." Bond premium is amortized over the term of such 2006 Bonds for federal income tax purposes (or, in the case of a 2006 Bond with bond premium callable prior to its stated maturity, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such Bond). Owners of such 2006 Bonds are required to decrease their adjusted basis in such 2006 Bonds by the amount of amortizable bond premium attributable to each taxable year such 2006 Bonds are held. The amortizable bond premium on such 2006 Bonds attributable to a taxable year is not deductible for federal income tax purposes; however, bond premium is treated as an offset to qualified stated interest received on such 2006 Bonds. Owners of such 2006 Bonds should consult their tax advisors with respect to the determination for federal income tax purposes of the treatment of bond premium upon sale or other disposition of such 2006 Bonds and with respect to state, Commonwealth and local tax consequences of owning and disposing of such 2006 Bonds.

Backup Withholding

The Tax Increase Prevention and Reconciliation Act of 2005, enacted on May 17, 2006, contains a provision under which interest paid on tax-exempt obligations will be subject to information reporting in a manner similar to interest paid on taxable obligations. Although the new reporting requirement does not, in and of itself, affect the excludability of such interest from gross income for federal income tax purposes, the reporting requirement causes the payment of interest on the 2006 Bonds made after March 31, 2007 to be subject to backup withholding if such interest is paid to registered owners who (a) are not "exempt recipients," and (b) either fail to provide certain identifying information (such as the registered owner's taxpayer identification number) in the required manner or have been identified by the IRS as having failed to report all interest and dividends required to be shown on their income tax returns. Generally, individuals are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients. Amounts withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or a credit against such beneficial owner's federal income tax liability provided the required information is furnished to the IRS.

LEGAL INVESTMENT

The 2006 Bonds will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for insurance companies to qualify them to do business in Puerto Rico as required by law.

UNDERWRITING

The Underwriters have agreed jointly and severally, subject to certain conditions, to purchase the 2006 Bonds from the University at a discount of $3,310,164.19 from the initial public offering prices set forth or derived from information set forth on the inside cover page. The Underwriters will be obligated to purchase all 2006 Bonds if any such Bonds are purchased. The obligation of the Underwriters to purchase the 2006 Bonds is subject to certain conditions. The 2006 Bonds may be offered and sold to certain dealers (including dealers depositing the 2006 Bonds into investment trusts) and institutional purchasers at prices lower than the public offering prices which may be changed, from time to time, by the Underwriters.

Morgan Stanley & Co. Incorporated ("Morgan Stanley") has entered into a joint venture agreement (the "JV Agreement") with Popular Securities, Inc. ("Popular"), under which the parties shall provide services and advice to each other related to the structuring and execution of certain municipal finance transactions in the U.S. capital markets with governmental entities located in the Commonwealth. Pursuant to the terms of the JV Agreement and in compliance with applicable rules, the parties will be entitled to receive a portion of each other's net profits from the underwriting of the 2006 Bonds as consideration for their professional services.

The University has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Federal securities laws.

CONTINUING DISCLOSURE

In order to assist the Underwriters in complying with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the Securities and Exchange Commission (the "SEC"), the University and the Commonwealth have agreed for the Beneficial Owners of the 2006 Bonds (generally, the tax owners thereof) to provide certain updated financial information and operating data annually and in the case of the University, timely notice of specified material events, for as long as any Bonds remain outstanding. This information will be available to securities brokers and others who subscribe to receive the information.

University Covenant

The University specifically agrees that:

(1) it will file within 305 days after the end of each fiscal year, commencing with the fiscal year ending June 30, 2006, with each NRMSIR and with any Commonwealth state information depository ("SID"), core financial information and operating data for the prior fiscal year, including (i) the University's audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) of the University System and revenues, expenditures, financial operations and indebtedness generally found in this Official Statement; and

(2) it will file in a timely manner, with each NRMSIR or with the MSRB, and with any Commonwealth or SID, the notices required to be provided by the Rule, which notices include, if material, the following:

(i) principal and interest payment delinquencies;
(ii) non-payment related defaults;
(iii) unscheduled draws on debt service reserves reflecting financial difficulties;
(iv) unscheduled draws on credit enhancements reflecting financial difficulties;
(v) substitution of credit or liquidity providers, or their failure to perform;
(vi) adverse opinions or events affecting the tax-exempt status of the 2006 Bonds;
(vii) modifications to rights of holders of the 2006 Bonds;
(viii) 2006 Bond calls;
(ix) defeasances;
(x) release, substitution, or sale of property securing repayment of the 2006 Bonds; and
(xi) rating changes.

With respect to the following events:

Events (iv) and (v) - The University does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the 2006 Bonds, unless the University applies for or participates in obtaining the enhancement.

Event (vi) - For information on the tax status of the 2006 Bonds, see "TAX MATTERS."

Event (viii) - The University does not undertake to provide the above-described notice in respect of any scheduled redemption, not otherwise contingent upon the occurrence of an event, if (i) the terms, dates and amounts of such redemption are set forth in detail in this Official Statement under "THE 2006 BONDS -- Mandatory Redemption," (ii) the only open issue is which 2006 Bonds will be redeemed in the case of a partial redemption, (iii) notice of redemption is given to the holders of the 2006 Bonds as required under the terms of the 2006 Bonds and the Trust Agreement, and (iv) public notice of redemption is given pursuant to Securities Exchange Act of 1934 Release No. 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or purchases of 2006 Bonds.

Commonwealth Covenant

The Commonwealth has covenanted: (i) to file, within 305 days after the end of each fiscal year of the Commonwealth, commencing with the fiscal year ending June 30, 2006, annual financial statements, prepared in accordance with U.S. generally accepted accounting principles, and operating data generally consistent with the Commonwealth Report and the Commonwealth Annual Financial Report, both of which have been incorporated by reference herein, with each NRMSIR and with any Commonwealth SID, and (ii) to file, in a timely manner, with each NRMSIR or with the MSRB, and with any Commonwealth SID, notice of a failure by the Commonwealth to provide the financial statements and operating data described in clause (i) on or before the date specified above.

The Commonwealth expects to provide the information described in (i) above by delivering the first bond official statement of the Commonwealth or of any instrumentality of the Commonwealth that includes its financial statements for the preceding fiscal year and operating data generally containing the information set forth in the Commonwealth Report or, if no official statement is issued by the 305-day deadline, by delivering such Report and the Commonwealth Annual Financial Report by such deadline.

The Commonwealth has made similar continuing disclosure covenants in connection with prior bond issuances, and has complied with all such covenants, except as hereinafter noted. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2002 were filed after the Commonwealth's filing deadline of May 1, 2003 because of delays in finalizing such financial statements resulting from the implementation of Governmental Accounting Standards Board Statement No. 34 ("GASB 34"). The Commonwealth's audited financial statements for the fiscal year ended June 30, 2003 were also filed after the Commonwealth's filing deadline of April 30, 2004, because of delays in finalizing the financial statements of certain of the Commonwealth's reporting units due to the implementation of GASB 34. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2004 were also filed after the Commonwealth's filing deadline of May 1, 2005, because various governmental agencies did not submit their audited financial statements to the central government's external auditors on time, thereby delaying the submission of the Commonwealth's audited financial statements.

Purpose and Enforceability of Covenants

The University and the Commonwealth acknowledge that their undertakings described above are intended to be for the benefit of the Beneficial Owners of the applicable series of Bonds, and shall be enforceable by any such Beneficial Owner, provided that the right to enforce the provisions of their respective undertakings shall be limited to a right to obtain specific performance of such provisions.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the University or the Commonwealth, as applicable, written notice of any request to cure such breach, and the University or the Commonwealth, as the case may be, shall have refused to comply within a reasonable time. All proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan, for the equal benefit of all Beneficial Owners of the outstanding Bonds benefitted by the Covenants, and no remedy shall be sought or granted other than specific performance of the Covenant at issue. Moreover, Proceedings filed by Beneficial Owners against the Commonwealth are subject to the sovereign immunity provisions of Section 2 of Act No. 104, approved June 19, 1955, as amended (32 L.P.R.A. §§ 3077 and 3077a), which governs the scope of legal actions against the Commonwealth, and provides certain notice provisions, the failure to comply with which may further limit any recovery.

As of November 30,2006, there is no Commonwealth SID, and the name and address of each NRMSIR are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's J.J. Kenny Repository, 55 Water Street, 45th Floor, New York, New York 10041; FT Interactive Data, Att: NRMSIR, 100 William Street, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

As required by Act No. 272 of May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the University in connection with the offering of the 2006 Bonds. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates also participate in other financial transactions with Government Development Bank.

LEGAL MATTERS

Legal matters incident to the authorization, issuance, sale and delivery of the 2006 Bonds are subject to the unqualified approving legal opinion of Sidley Austin LLP, New York, New York, Bond Counsel. The form of opinions of Bond Counsel is set forth in Appendix B**.** Certain legal matters will be passed upon for the Underwriters by Quiñones & Sánchez PSC, San Juan, Puerto Rico.

INDEPENDENT AUDITORS

The financial statements of the University as of June 30, 2005 and for the year then ended have been audited by Ernst & Young LLP, independent auditors, as stated in their unqualified report included in Appendix A.

RATINGS

The 2006 Bonds have been assigned a rating of "Baa2" by Moody's and of "BBB" by S&P. Ratings reflect only the respective opinions of such rating agencies, and an explanation of the significance of ratings must be obtained from the respective rating agency Such rating agencies were provided with materials relating to the University and the 2006 Bonds and other relevant information, and no application has been made on any other rating agency for the purpose of obtaining a rating on the 2006 Bonds.

There is no assurance that the ratings will continue for any given period of time or will not be revised downward or withdrawn entirely by either or both of such rating agencies. Any downward revision or withdrawal of the ratings could have an adverse effect on the market prices of the 2006 Bonds.

MISCELLANEOUS

The foregoing references to and summaries of certain Federal, Commonwealth and local laws, including, but not limited to, the laws of Puerto Rico, Act No.2 of 1966, Act No. 64, Act No. 2 of 1974, Act No. 83 and Act No, 16, and documents and agreements, including but not limited to the Trust Agreement, are made subject to all the detailed provisions thereof. Such references and summaries do not purport to be complete and are qualified in their entirety by reference to such acts, laws, documents, agreements or decisions. Copies of the Trust Agreement are available for inspection during regular business hours at the offices of Government Development Bank or at the corporate trust office of the Trustee.

The Commonwealth will provide without charge to any person to whom this Official Statement is delivered, on the written or oral request of such person, a copy of the Commonwealth Report and the Commonwealth Annual Financial Report incorporated herein by reference. Requests for such document should be directed to Director-New York Office, Government Development Bank for Puerto Rico 666 Fifth Avenue, 15th Floor, New York, N.Y. 10103-1599, telephone number (212) 422-6420, or to Director-General Obligations Division, Government Development Bank for Puerto Rico, P.O. Box 42001, Santurce, PR 00940, telephone number (787) 722-7060.

A copy of the Commonwealth Report and the Commonwealth Financial Report may also be obtained by contacting a NRMSIR. The address of each NRMSIR is set forth in "CONTINUING DISCLOSURE" above.

The information in the Commonwealth Report and the Commonwealth Annual Financial Report was supplied by certain officials of the Commonwealth or certain of its agencies or instrumentalities, in their respective official capacities, or was obtained from publications of the Commonwealth or certain of its agencies or instrumentalities, and is incorporated by reference in this Official Statement on the authority of such officials or the authority of such publications as public official documents, respectively. The information pertaining to DTC was supplied by DTC. The remaining information set forth in this Official Statement, except for any language which has been specifically identified as having been provided by the Underwriters and the information appearing in "UNDERWRITING" and Appendix B, was supplied to the University and is included in this Official Statement on its authority.

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

UNIVERSITY OF PUERTO RICO

By : /s/Antonio García Padilla
President

APPENDIX – A

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AUDITED FINANCIAL STATEMENTS

University of Puerto Rico
Years Ended June 30, 2005 and 2004

University of Puerto Rico

Audited Financial Statements

Years Ended June 30, 2005 and 2004

Contents

Report of Independent Auditors

Board of Trustees
University of Puerto Rico

We have audited the accompanying statement of net assets of the University of Puerto Rico (the University), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2005 and 2004 and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Servicios Médicos Universitarios, Inc. (the Hospital) and Desarrollos Universitarios, Inc. (the Company), discretely presented component units, as of and for the years ended June 30, 2005 and 2004 and March 31, 2005 and 2004, respectively. Those financial statements were audited by other auditors whose report has been furnished to us. The Hospital's report included an explanatory paragraph stating that it has experienced recurring losses since it commenced operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Our opinion, insofar as it relates to data included for the Hospital and the Company is solely based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Puerto Rico as of June 30, 2005 and 2004, and its changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 12 to the financial statements, the Hospital has experienced recurring losses since it commenced operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern.

In accordance with *Government Auditing Standards*, we have also issued our report, dated October 31, 2005, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

Our audits were performed primarily for the purpose of forming an opinion on the financial statements of the University of Puerto Rico taken as a whole. The schedule of changes in sinking fund reserves included in page 49 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion is fairly stated in all material respects in relation to the financial statements taken as a whole.

As disclosed in Note 1 to the financial statements, the University adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, D*eposit and Investment Risk Disclosure and amendment of GASB3*, during 2005.

Ernst + Young LLP

October 31, 2005, except for
the third paragraph of
Note 15, as to which the
date is November 19, 2005

Stamp No. 2093888
affixed to original
of this report.

Introduction

The following discussion presents an overview of the financial position and financial activities of the University of Puerto Rico (the University) for the years ended June 30, 2005 and 2004. This discussion was prepared by University management and should be read in conjunction with the financial statements and notes thereto, which follow.

Financial Highlights

The financial position of the University remains strong at June 30, 2005, with total assets of \$1,048,745,000 total liabilities of \$741,092,000 and net assets of \$307,654,000. University net assets increased \$6,892,000 during the year ended June 30, 2005 when compared to \$4,114,000 during June 30, 2004. This increase is explained in the section entitled "Analysis of Financial Position and Results of Operations." An overview of the statements is presented below along with a financial analysis of the transactions impacting the statements.

Condensed financial statements for the University as of and for the years ended June 30, 2005 and 2004 follow:

Condensed Statement of Net Assets

	June 30		
	2005	**2004**	**2003**
Assets			
Current assets	**$ 298,621,981**	$ 324,488,255	$ 343,492,432
Noncurrent assets:			
Due from Commonwealth of Puerto Rico	**71,570,127**	22,710,382	-
Capital	**629,903,127**	591,331,872	568,604,803
Other	**48,650,332**	41,365,027	33,678,864
Total assets	**$1,048,745,567**	$979,895,536	$ 945,776,099
Liabilities			
Current liabilities	**$ 188,106,410**	$ 135,275,117	$ 104,847,662
Noncurrent liabilities	**552,985,169**	543,858,433	544,280,641
Total liabilities	**$741,091,579**	$679,133,550	$ 649,128,303
Net assets			
Invested in capital assets net of related debt	**$ 183,741,045**	$ 164,188,965	$ 150,639,405
Restricted:			
Nonexpendable	**45,310,063**	38,902,830	31,906,293
Expendable	**85,968,022**	91,944,811	100,138,696
Unrestricted	**(7,365,142)**	5,725,380	13,963,402
Total net assets	**$307,653,988**	$300,761,986	$ 296,647,796

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	2005	2004	2003
Operating revenues			
Tuition and fees	**$ 36,951,309**	$ 40,235,263	$ 38,844,683
Grants and contracts	**257,270,339**	251,075,661	246,523,874
Patient services	**43,589,157**	50,675,183	53,329,127
Other operating revenues	**38,852,582**	38,466,965	30,579,768
Total operating revenues	**376,663,387**	380,453,072	369,277,452
Operating expenses	**1,182,072,684**	1,120,598,736	1,040,994,779
Operating loss	**(805,409,297)**	(740,145,664)	(671,717,327)
Nonoperating revenues			
State appropriations	**796,568,502**	743,632,033	695,550,184
Other nonoperating expenses, including interest on indebteness	**(2,998,029)**	(6,852,732)	(9,243,174)
Net nonoperating revenues	**793,570,473**	736,779,301	686,307,010
Income before other revenues	**(11,838,824)**	($3,366,363)	14,589,683
Capital appropriations	**12,323,593**	2,243,129	691,592
Addition to permanent endowment	**6,407,233**	5,237,424	8,332,474
Total increase in net assets	**$ 6,892,002**	$ 4,114,190	$ 23,613,749

Condensed Statements of Cash Flows

Cash and cash equivalents (used in) provided by			
Operating activities	**$ (745,410,567)**	$ (711,317,046)	$ (658,450,757)
Noncapital financing activities	**811,364,868**	755,518,466	708,285,700
Capital and related financing activities	**(74,371,268)**	(79,302,909)	(88,222,791)
Investing activities	**(12,838,861)**	(13,331,357)	48,728,417
Net decrease in cash and cash equivalents	**(21,255,828)**	(48,432,846)	10,340,569
Cash and cash equivalents - beginning of year	**56,827,882**	105,260,728	94,920,159
Cash and cash equivalents - end of year	**$ 35,572,054**	$ 56,827,882	$ 105,260,728

Using the Financial Statements

The University's financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement No. 34, Basic *Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* This was followed in November 1999 by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34;* in June 2002 by GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus – an Amendment of GASB Statement No. 21 and No. 34;* in June 2002 by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*; and also in May 2002 by GASB Statement No. 39, *Determining whether Certain Organizations on Components Units*.

These statements became effective for the years ended June 30, 2002 through 2004. The financial statement presentation required by GASB Statements No. 34 and 35 provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

Analysis of Financial Position and Results of Operations

Statement of Net Assets

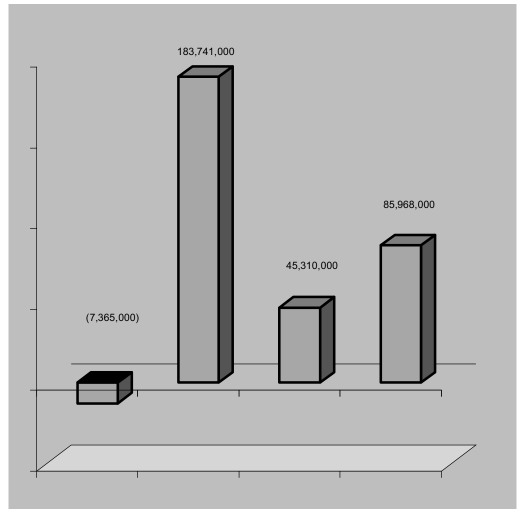
The statement of net assets presents the assets, liabilities and net assets of the University as of June 30, 2005 and 2004. The net assets are displayed in three parts, invested in capital assets net of related debt, restricted and unrestricted. Restricted net assets may either be expendable or nonexpendable and are those assets that are restricted by law or by an external donor. Unrestricted net assets, while they are generally designated for specific purposes, are available for use by the University to meet current expenses for any purposes. The statement of net assets, along with all of the University's basic financial statements, is prepared under the accrual basis of accounting, whereby revenues are recognized when the service is provided and expenses are recognized when others provide the service to the University, regardless of when cash is exchanged.

Assets included in the statement of net assets are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, short-term investments and accounts receivable. Of these amounts, cash and cash equivalents, investments and accounts receivable comprise approximately 9.4%, 25% and 57%, respectively, of current assets as of June 30, 2005. Approximately 93% of noncurrent assets are capital assets.

University's cash, cash equivalents and investments decreased from $175,651,000 at June 30, 2004 to $170,383,000 at June 30, 2005. Current accounts receivable decreased from $161,078,000 to $142,189,000 for the same periods. The increase in Accounts Receivables net is due, basically by the increase in grants, contracts and appropriation with the Commonwealth of Puerto Rico and the Federal Government.

Current liabilities consist primarily of accounts payable and accrued liabilities and the current portion of long-term debt. Accounts payable and accrued liabilities increased from $81,097,000 to $101,262,000 between June 30, 2004 and 2005. The increase is due to an Annual Required Contribution to the University´s Retirement System and the employees, according of GASB Statement No. 16. Noncurrent liabilities consist primarily of bonded indebtedness and notes payable. Long-term debt decreased from $397,835,000 and to $382,261,000 for the same period as a result, mostly, of the repayment of principal.

Net assets represent the residual interest in the University's assets after liabilities are deducted and are classified into one of four categories as shown on the following illustration:



Unrestricted	(7,365,000)
Invested in Capital Assets	183,741,000
Restricted Nonexpendable	45,310,000
Restricted Expendable	85,968,000

Net assets invested in capital assets, net of related debt amounting to $183,741,000 represent the University's capital assets less accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Restricted nonexpendable net assets, amounting to $45,310,000 consist primarily of the University's permanent endowment funds. The corpus of these funds may not be expended and must remain with the University in perpetuity. Only the earnings from these funds may be expended. Restricted expendable net assets, amounting to $85,968,000 are subject to externally imposed restrictions governing their use. The funds are restricted primarily for debt service, capital projects, student loans and scholarship purposes.

Unrestricted net assets amounting to $(7,365,000) represent those balances from operational activities that have not been restricted by parties external to the University such as donors or grant agencies. This includes funds that have been designated by the governing board for specific purposes as well as amounts that have been contractually committed for goods and services which have not yet been received. Approximately one half of the net assets relate to capital projects, which are in various stages of planning and completion.

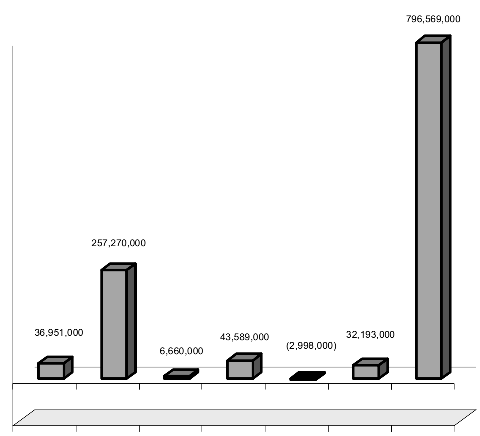
Statement of Revenues, Expenses and Changes in Net Assets

Changes in total University net assets as presented on the statement of net assets are based on the activity presented in the statement of revenues, expenses and changes in net assets. The purpose of the statement is to present the revenues received by the university, both operating and nonoperating, and the expenses paid by the University, operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by the University.

Generally, operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided. GASB Statement No. 34, as amended by GASB Statement No. 35 requires that statement appropriations be classified as nonoperating.

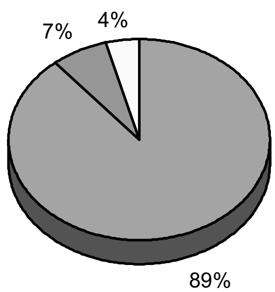
Approximately 91% of the operating revenues and non operating revenues of the University are federal and Commonwealth appropriations grants and contracts. The remainder consists primarily of tuition and fees and patient services.

The following illustration presents the major sources of University revenues (both operating and nonoperating) for the year ended June 30, 2005:



Tuitions & Fees	36,951,000
State and Federal Grants & Contracts	257,270,000
Auxiliary Enterprises	6,660,000
Patient services	43,589,000
Nonoperating Revenues	(2,998,000)
Other Operating Revenues	32,193,000
State Appropiations	796,569,000

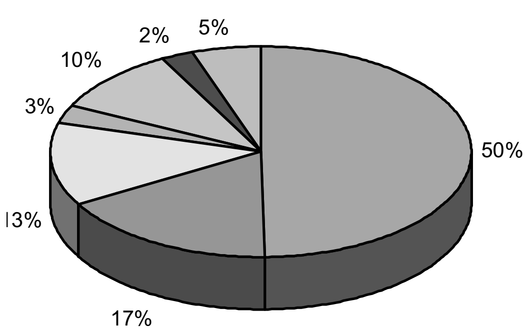
Analysis of Grants Revenues



Federal	238,302,090	89%
Commonwealth	18,968,249	7%
Other	10,852,762	4%

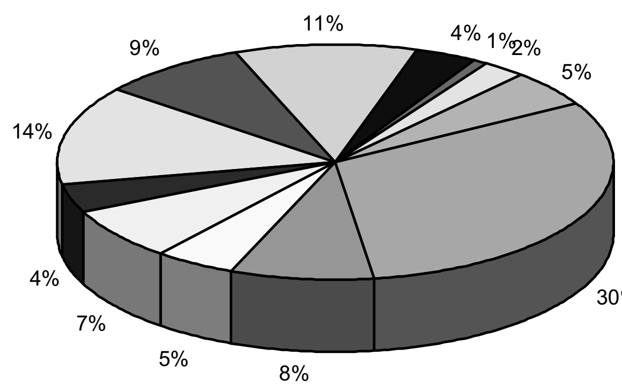
University expenses are presented using natural expense classifications. Salaries and benefits represent 67% of the University's operating expenses.

The following illustration presents the major University operating expenses, using natural classification for the year ended June 30, 2005:



Salaries	$ 588,045,000	50%
Benefits	199,436,000	17%
Scholarship and others services	151,106,000	13%
Utilites	33,152,000	3%
Supplies and others services	117,982,000	10%
Depreciation	29,354,000	2%
Others Expenditures	62,997,000	5%

Functional expense classification presents University expenses in the operational categories they benefit. The following illustration presents the major uses of University revenues (both operating and nonoperating) on a functional basis for the year ended June 30, 2005.



Instruction	367,702,000	30%
Research	98,034,000	8%
Public Service	56,022,000	5%
Academic Support	85,615,000	7%
Student Services	45,480,000	4%
Institutional Support	162,697,000	14%
Operation and Maintenance of Plant	101,530,000	9%
Scholarships and Fellowships	124,768,000	11%
Auxiliary Enterprises	42,391,000	4%
Patient service	10,609,000	1%
Depreciation	29,354,000	2%
Other	57,870,000	5%

For the year ended June 30, 2005, the University reported an operating loss of approximately $(805,409,000). After adding non-operating revenue and expenses, primarily state appropriations, the total increase in net assets for the year is approximately $6,892,000.

Statement of Cash Flows

The statements of cash flows present information related to cash flows of the University. The statement presents cash flows by category: operating activities, noncapital financing activities, capital and related financing activities and investing activities. The net cash provided to, or used by the University is presented by category.

Increases in cash and cash equivalents from noncapital financing activities were due primarily to the receipt of state appropriations and increases in cash and cash equivalents from investing activities resulted from maturities of short-term investments. Those increases were offset by decreases in cash and cash equivalents from capital and related financing activities and cash used in operating activities. Cash and cash equivalents decreased from capital and related debt activity due primarily to purchases of capital assets and payment of principal and interest on debt. The decrease in cash and cash equivalents from operating activities is consistent with the University's operating loss.

Capital Assets and Debt Administration

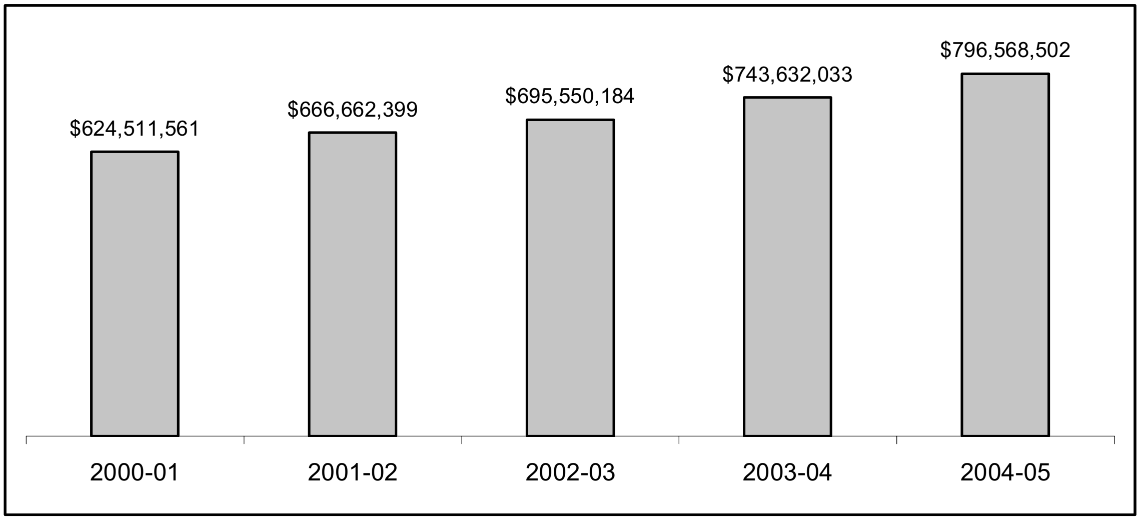
Significant capital assets additions for the year ended June 30, 2005 consist mainly of renovation and rehabilitation of existing facilities, restoration of historic buildings, and modifications of existing facilities in light of new technology, educational standards and the requirements of modern building codes.

During fiscal year 2005, the University borrowed $32,011,000 from the Governmental Development Bank, to finance new construction projects. Debt in the amount of approximately $17,486,000 was retired during the year.

Economic Outlook

The economy of Puerto Rico must be analyzed as a region within the U.S. economy, since it is part of the U.S. monetary and banking system, as well as within its territorial boundaries. The main driver of the Puerto Rico economy is a huge external sector closely tied to the flow of merchandise, tourists, and capital between Puerto Rico and the Mainland. Thus, historically, the real growth rates of the Puerto Rico economy have closely followed those of the U.S. economy. In fiscal year 2005, real GDP of Puerto Rico economy continued to expand at rate of 3.0%. The overall expansion of the economy of Puerto Rico was negatively affected by a decline in the U.S. real GDP growth rate.

The Commonwealth appropriations for the last five years are illustrated below:



The University administration is not aware of any currently known facts, decisions or conditions that are expected to have a significant effect on the University's financial position or results of operation during fiscal year 2005 beyond those unknown variations having a global effect on virtually all types of business operations. While the University's overall financial position is strong, various factors influence the University's ultimate financial success.

	June 30 2005	June 30 2004
Assets		
Current assets:		
Cash and cash equivalents	**$ 34,073,287**	$ 55,330,233
Investments at fair value	**51,044,877**	42,380,461
Investments with bond trustees at fair value	**39,093,146**	39,099,123
Accounts receivable (less allowances for doubtful accounts of $96,379,608 and $75,841,858 for 2005 and 2004, respectively)	**142,189,387**	161,077,900
Inventories	**8,000,211**	7,455,868
Prepaid expenses and other assets	**24,221,073**	19,144,670
Total current assets	**298,621,981**	324,488,255
Noncurrent assets:		
Restricted cash and cash equivalents	**1,498,767**	1,497,649
Investments at fair value	**44,672,823**	37,343,883
Due from Commonwealth of Puerto Rico	**71,570,127**	22,710,382
Notes receivable, net	**2,478,742**	2,523,495
Capital assets (net accumulated depreciation of $362,900,414 and $340,650,082 for 2005 and 2004, respectively)	**629,903,127**	591,331,872
Total noncurrent assets	**750,123,586**	655,407,281
Total assets	**$ 1,048,745,567**	$ 979,895,536
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 101,261,852**	$ 81,097,273
Current portion of long-term debt	**63,901,010**	31,531,864
Other current liabilities	**22,943,548**	22,645,980
Total current liabilities	**188,106,410**	135,275,117
Noncurrent liabilities:		
Long-term debt, net of current portion	**382,261,072**	397,834,520
Other long-term liabilities	**170,724,097**	146,023,913
Total noncurrent liabilities	**552,985,169**	543,858,433
Total liabilities	**$ 741,091,579**	$ 679,133,550

See accompanying notes.

	June 30 2005		June 30 2004	
Net assets				
Invested in capital assets, net of related debt	**$**	**183,741,045**	$	164,188,965
Restricted, nonexpendable				
Sholarship & fellowships		**23,837,318**		20,979,392
Research		**18,546,717**		13,292,145
Other		**2,926,028**		4,631,293
Restricted, expendable				
Research		**15,729,216**		13,180,651
Loans		**7,881,602**		7,996,322
Capital projects		**5,662,370**		6,679,951
Debt service		**37,501,622**		39,838,432
Other		**19,193,212**		24,249,455
Unrestricted		**(7,365,142)**		5,725,380
Total net assets	**$**	**307,653,988**	$	300,761,986

See accompanying notes.

University of Puerto Rico
Statements of Revenues, Expenses and Changes in Net Assets

	June 30 2005	June 30 2004
Revenues		
Operating revenues:		
Tuitions and fees (net of scholarship allowances of $28,822,302 and $30,100,834 for 2005 and 2004, respectively)	**$ 36,951,309**	$ 40,235,263
Net hospital patient services and other	**43,589,157**	50,675,183
Federal grants and contracts	**238,302,090**	238,477,529
Commonwealth grants and contracts (net of allowances of $4,893,254 and $9,895,867 for 2005 and 2004, respectively)	**18,968,249**	12,598,132
Nongovermental grants and contracts	**10,852,762**	11,366,647
Sales and services of educational departments	**5,935,971**	4,726,381
Auxiliary enterprises (net of scholarship allowances of $146,715 and $4,146 for 2005 and 2004, respectively)	**6,659,812**	6,748,690
Other operating revenues	**15,404,037**	15,625,247
Total operating revenues	**376,663,387**	380,453,072
Expenses		
Salaries:		
Faculty	**339,512,616**	323,245,761
Exempt staff	**246,050,912**	229,202,035
Nonexempt wages	**2,481,087**	2,808,706
Benefits	**199,435,760**	179,020,688
Scholarship and fellowship	**151,106,021**	154,139,641
Utilities	**33,152,547**	31,234,988
Supplies and other services	**117,982,519**	121,930,100
Depreciation	**29,353,945**	34,266,264
Other expenses	**62,997,277**	44,750,553
Total operating expenses	**1,182,072,684**	1,120,598,736
Operating loss	**(805,409,297)**	(740,145,664)
Nonoperating revenues (expenses):		
Commonwealth appropriations	**796,568,502**	743,632,033
Gifts	**7,284,899**	6,010,379
Net investment income	**3,154,496**	3,023,248
Interest on indebtedness	**(14,541,657)**	(16,524,989)
Other nonoperating revenues	**1,104,233**	638,630
Net nonoperating revenues	**793,570,473**	736,779,301
Loss before other revenues	**(11,838,824)**	(3,366,363)
Capital appropriations	**12,323,593**	2,243,129
Additions to term and permanent endowment	**6,407,233**	5,237,424
Increase in net assets	**6,892,002**	4,114,190
Net Assets		
Beginning of year	**300,761,986**	296,647,796
End of year	**$ 307,653,988**	$ 300,761,986

See accompanying notes.

University of Puerto Rico
Statements of Cash Flows

	Year Ended June 30 2005	2004
Cash flows from operating activities		
Tuition and fees	**$ 37,297,489**	$ 40,113,831
Grants and contracts	**255,755,608**	255,434,259
Patient services	**43,589,157**	50,675,184
Auxiliary enterprises	**6,349,042**	6,654,215
Sales and services educational depatrments	**10,203,787**	(3,624,511)
Payments to suppliers and vendors	**(117,067,834)**	(121,921,472)
Payments to employees	**(594,941,568)**	(548,196,193)
Payments for utilities	**(33,424,034)**	(31,216,778)
Payments for benefits	**(149,236,160)**	(154,604,323)
Payments for scholarships and fellowships	**(151,084,619)**	(154,140,705)
New loans issued to students	**(1,513,505)**	(2,435,729)
Student loan repayments	**1,558,255**	1,769,508
Other payments	**(52,896,185)**	(49,824,332)
Net cash used in operating activities	**(745,410,567)**	(711,317,046)
Cash flows from noncapital financing activities		
Commonwealth appropriations	**796,568,502**	743,632,033
Endowment gifts	**6,407,233**	5,237,424
Gifts and grants for other than capital purposes	**8,389,133**	6,649,009
Net cash provided by noncapital financing activities	**811,364,868**	755,518,466
Cash flows from capital and related financing activities		
Capital appropriations	**12,323,593**	2,243,129
Net purchases of capital assets	**(86,684,521)**	(61,085,487)
Principal paid on capital debt	**(17,485,773)**	(21,447,422)
Interest paid on capital debt	**(14,541,657)**	(16,524,989)
Deposit with trustee	**5,977**	1,560,404
Proceeds from capital debt	**32,011,113**	15,951,456
Net cash used in capital and related financing activities	**(74,371,268)**	(79,302,909)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	**17,050,968**	16,534,604
Purchase of investments	**(33,044,325)**	(32,889,209)
Interest on investments	**3,154,496**	3,023,248
Net cash used in investing activities	**(12,838,861)**	(13,331,357)
Net change in cash and cash equivalents	**(21,255,828)**	(48,432,846)
Cash and cash equivalents:		
Beginning of period	**56,827,882**	105,260,728
End of period	**$ 35,572,054**	$ 56,827,882

	Year Ended June 30	
	2005	**2004**
Reconciliation of net operating revenues (expenses) to net cash used in operating activities		
Operating loss	**$ (805,409,297)**	$ (740,145,664)
Adjustments to reconcile net loss to net cahs used in operating activities:		
Depreciation expense	**29,353,945**	34,266,264
Reduction of capital assets	**18,759,321**	4,092,154
Amortization on land premium, discount and future appreciated principal	**2,270,359**	2,069,141
Changes in assets and liabilities, net:		
Grants and contracts receivables	**(29,971,230)**	(36,920,674)
Other receivables		
Prepaid expenses, inventories and other	**(5,620,747)**	(7,444,118)
Accounts payable and accrued liabilities	**20,209,330**	17,617,019
Accrued salaries and wages and other liabilities	**24,997,752**	15,148,832
Net cash used in operating activities	**$ (745,410,567)**	$ (711,317,046)

See accompanying notes.

Discretely Presented Component Unit
(Servicios Médicos Universitarios, Inc.)
Balance Sheets

	Year Ended June 30	
	2005	**2004**
Assets		
Current assets:		
Cash	**$ 977,009**	$ 834,927
Patient accounts receivable, net of allowance for doubtful accounts of $29,174,559 in 2005 and $24,663,708 in 2004	**11,413,732**	10,468,354
Estimated third-party payor settlement - Medicare	**-**	410,347
Accounts receivable - other	**262,486**	217,514
Inventories of supplies	**1,835,051**	1,535,453
Prepaid expenses	**868,525**	877,233
Total current assets	**15,356,803**	14,343,828
Property and equipment, net	**3,283,246**	2,551,845
Total assets	**$ 18,640,049**	$ 16,895,673
Liabilities and deficiency in unrestricted net assets		
Current liabilities:		
Current portion of long term debt	**$ 15,367,611**	$ 15,367,611
Current portion of capital lease obligations	**278,984**	338,073
Accounts payable	**16,131,047**	14,147,967
Accrued interest	**2,762,252**	1,912,252
Estimated third-party payor settlements-Medicare	**1,454,393**	-
Accrued payroll taxes and employee benefits	**1,505,430**	1,577,899
Accrued expenses	**4,345,815**	4,266,459
Total current liabilities	**41,845,532**	37,610,261
Long-term debt, net of current portion	**1,632,389**	1,632,389
Capital lease obligations, net of current portion	**-**	32,004
Due to related parties	**26,587,565**	23,668,541
Total liabilities	**70,065,486**	62,943,195
Commitments and contingencies		
Deficiency in unrestricted net assets	**(51,425,437)**	(46,047,522)
Total liabilities and deficiency in unrestricted net assets	**$ 18,640,049**	$ 16,895,673

See accompanying notes.

Discretely Presented Component Unit
(Servicios Médicos Universitarios, Inc.)
Statements of Operations and Deficiency in Unrestricted Net Assets

	Year Ended June 30	
	2005	**2004**
Unrestriced revenues and other support:		
Net patient service revenue	**$ 37,700,670**	$ 35,011,804
Other revenue	**1,445,330**	1,385,018
Total revenues and other support	**39,146,000**	36,396,822
Expenses:		
Salaries and benefits	**17,222,514**	15,843,487
Contracted services	**2,378,480**	2,365,146
Professional services	**964,299**	942,119
Supplies	**12,029,608**	11,426,480
Utilities	**1,664,010**	1,816,464
Interest	**977,478**	996,509
Provision for bad debs	**6,292,064**	3,990,269
Depreciation and amortization	**586,230**	776,989
Other	**2,409,233**	1,928,903
Total expenses	**44,523,916**	40,086,366
Net loss	**(5,377,916)**	(3,689,544)
Deficiency in unrestricted net assets, at beginning of year	**(46,047,522)**	(42,357,978)
Deficiency in unrestricted net assets, at end of year	**$ (51,425,438)**	$ (46,047,522)

See accompanying notes.

Discretely Presented Component Unit
(Desarrollos Universitarios, Inc.)
Balance Sheet

	Year Ended March 31 2005	2004
Assets		
Current assets:		
Cash	**$ 202,802**	$ 77,805
Restricted funds held by trustee	**25,695,460**	32,331,302
Project in process	**80,755,423**	70,965,964
Bond issance costs, net of accumulated amortization of $290,391 and $210,412	**2,498,833**	2,578,812
Prepaid expenses	**5,275**	5,110
Total assets	**$ 109,157,793**	$ 105,958,993
Liabilities and deficiency in fund balance		
Current liabilities:		
Construction contract, project management fee and other payables, including retainege of $2,451,894 in both years	**$ 3,077,199**	$ 3,787,561
Accrued interest payable	**1,097,533**	1,113,722
Accrued expenses	**111,964**	115,876
Unearned revenue	**19,896,569**	14,670,562
Bonds payable, net of discount of $368,015 and $394,091	**85,071,985**	86,340,909
Total current liabilities	**109,255,250**	106,028,630
Contingencies		
Deficiency in fund balance	**(97,457)**	(69,637)
Total liabilities and deficiency in fund balance	**$ 109,157,793**	$ 105,958,993

See accompanying notes.

Discretely Presented Component Unit
(Desarrollos Universitarios, Inc.)
Statements of Operations and Deficiency in Fund Balance

	Year Ended March 31	
	2005	**2004**
Expenses:		
General and administrative	**$ (27,820)**	$ (31,716)
Total expenses and excess of expenses over revenues	**(27,820)**	(31,716)
Deficiency in fund balance, beginning of year	**(69,637)**	(37,921)
Deficiency in fund balance, end of year	**$ (97,457)**	$ (69,637)

See accompanying notes.

1. Reporting Entity and Summary of Significant Accounting Policies

Reporting Entity

The University of Puerto Rico (the University) is a public corporation of the Commonwealth of Puerto Rico (the Commonwealth) governed by a thirteen-member Board of Trustees, of which ten are appointed by the Governor of Puerto Rico and confirmed by the Senate of Puerto Rico. The remaining members of the Board consist of one full-time student and two term professors. The Governor appointed the original members for terms from four to eight years. Upon expiration of their terms, the new members will be appointed for a period of six years. The terms for the student and professors are for one year.

The University is exempt from the payment of taxes on its revenues and properties. The University is a component unit of the Commonwealth.

The financial reporting entity of the University consists principally of Río Piedras, Mayagüez, Medical Sciences, Cayey, Humacao, Ponce, Bayamón, Aguadilla, Arecibo, Carolina and Utuado; and the Central Administration.

Appropriations from the Commonwealth are the principal source of revenues of the University and are supported by Act No. 2 of January 20, 1966, as amended. Under the Act, the Commonwealth appropriates for the University an amount equal to 9.60% of the average total amount of annual revenues collected under the laws of the Commonwealth in the two fiscal years immediately proceeding the current fiscal year. In addition, the Commonwealth has appropriated amounts for general current obligations, for capital improvement programs, and for loans and financial assistance to students.

Discretely Presented Component Unit Disclosures: A discretely presented component unit is an entity whose operations are separate from the University's but over whom the University has significant accountability. The University has two discretely presented component units as follows:

Servicios Médicos Universitarios, Inc.

Servicios Médicos Universitarios, Inc. (the Hospital) is legally separated from the University and is governed by a separate board. The Company is a not-for-profit acute care corporation, organized under the Laws of the Commonwealth of Puerto Rico, on February 11, 1998. The principal objectives of the Company are to constitute it as the principal medical education, institution of the University and to offer care services to the residents of Puerto Rico.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Servicios Médicos Universitarios Inc. (continued)

Desarrollos Universitarios, Inc.

Desarrollos Universitarios, Inc. (the Company) is legally separated from the University and is governed by a separate board. The Company was organized on January 22, 1997, under the laws of the Commonwealth of Puerto Rico as a not-for-profit organization. The Company was organized to develop, construct, and operate academic, residential, administrative, office, commercial, and maintenance facilities for the use of students and other persons or entities conducting business with the University of Puerto Rico (the University). Currently, the Company is in the process of developing the Plaza Universitaria (Plaza Universitaria) and the Central Air Condition System projects (the Projects), to be leased to the University. Plaza Universitaria will consist of a student housing facility, a multi-story parking building and an institutions building to house administrative, student service and support functions and to a lesser extent to lease commercial space. The financing for the Projects is being provided by the issuance of $86,735,000 in Educational Facilities Revenue Bonds through the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (AFICA).

The following is a summary of the significant accounting policies followed by the University:

Financial Statement Presentation

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. This was followed in November 1999 by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*; in June 2001 by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion ad Analysis – for State and Local Governments: Omnibus – an Amendment of GASB Statement No. 21 and No. 34*; and, also in June 2004 by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements are effective for the year ended June 30, 2003. The financial statement presentation required by GASB Statement Nos. 34, 35, 37 and 38 provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows and replaces the fund group perspective previously required.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Financial Statement Presentation (continued)

Significant accounting changes made in order to comply with the new requirements included the adoption of depreciation of capital assets, reporting tuition and fee revenue net of certain scholarship allowances and reporting revenue from auxiliary enterprises net of cost of goods sold and scholarships and allowances. Additionally, reclassifications of prior year balances have been made to conform to the current year presentation.

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures. This statement which amends GASB Statement No. 3, Deposits with Financial Institutions, Investments (Including Repurchase Agreements) and Reverse Repurchase Agreements*, is effective for the University for the year ending June 30, 2005.

The University will be required to address common deposit and investment risk to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. This statement also requires certain values that are highly sensitive to changes in interest rates. The University is also required to disclose its deposit and investment policies.

Measurement Focus and Basis of Accounting

For financial reporting purposes, the University is considered a special purpose governmental agency engaged only in business type activities, as defined by GASB Statement No. 34. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant transactions related to internal service activities such as publications, telecommunications and institutional computing have been eliminated where appropriate.

The University has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB pronouncements conflict with GASB pronouncements. The University has elected to not apply FASB pronouncements issued after the applicable date.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Cash Equivalents

The University considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents.

Investments

Investments are reported at fair value in the statements of net assets. The changes in the fair value of investments are reported in the statements of revenues, expenses and changes in net assets as a component of net investment income.

Donated investments are recorded at their fair value at the date of donation. Investments of the Deferred Compensation Plan are valued at fair value in order to measure the current liability attributable to plan participants.

Restricted Funds Held by Trustee – Discretely Presented Component Unit

Restricted funds of Desarrollos Universitarios, Inc. held by trustee at March 31, 2005 and 2004 consist of money market funds and zero coupon bonds purchased with remaining maturities of six months or less.

Capital Assets

All capital expenditures of $1,000 or more and having a useful life of two or more years are capitalized at cost at the date of acquisition. Donated assets are recorded at estimated fair value at the date of donation. Depreciation is recorded using the straight-line method over the estimated useful lives of the assets, generally 25 to 50 years for buildings and infrastructure, 5 to 20 years for equipment and library materials, and 7 to 30 years for land improvements. Renovations to buildings and other assets that significantly increase the value or extend the useful life of the asset capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred.

Inventories

Inventories are valued at the lower of first-in, first-out cost or market and consist primarily of books.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Classification of Net Assets

The University's net assets are classified as follows:

Invested in capital assets, net of related debt represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted, nonexpendable net assets consist of endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

Restricted, expendable net assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, hospital revenues, sales and services of educational activities and auxiliary enterprises. Auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty and staff. While unrestricted net assets may be designated for specific purposes by action of managements or the Board of Trustees, they are available for use, at the discretion of the governing board, to meet current expenses for any purpose. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Scholarship Allowances and Student Financial Aid

Student tuition and fees, and certain other revenues from students, are expected net of scholarship discounts and allowances in the statement of revenues, expenses and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants and other federal, state or nongovernmental programs, are recorded as either operating or nonoperating revenues in the University's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and certain other student charges, the University has recorded a scholarship discount and allowance.

Bond Premium/Discount and Deferred Issuance Costs

Bond premium and/or discount and deferred issuance costs are amortized using the effective interest method.

Deferred Compensation Plan

The University offers certain employees a non-qualified deferred compensation plan which was created pursuant to Certification No. 94 of the Council of Higher Education, dated February 13, 1984. The plan, managed by independent plan administrators, permits employees to defer a portion of their salary until future years. At the employee's election, such amounts may be invested in mutual funds, which represent varying levels of risk and return. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to these amounts, are (until paid or made available to the employee or other beneficiary) solely the property and rights of the University (without being restricted to the provisions of benefits under the plan), subject only to the claims of the University's general creditors. Participants' rights under the plan are equal to that of general creditors of the University in an amount equal to the fair market value of the deferred account for each participant. It is the opinion of the University's legal counsel that the University has no liability for the losses under the plan but does have the duty of care that would be required of an ordinary prudent investor. The University believes that it is unlikely that it will use the assets of the plan to satisfy the claims of general creditors in the future.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Compensated Absences

The vacation policy of the University generally provides for the accumulation of 2.5 days per month. Unpaid vacation time accumulated is fully vested to the employees from the first day of work.

Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. The University pays, annually, the excess of 90 days of accumulated sick leave to the employees. Upon retirement, an employee receives compensation for all accumulated unpaid sick leave at the then current rate, provided the employee has at least 10 years of service with the University. During the years ended June 30, 2005 and 2004, the cost of the excess of 90 days of the accumulated sick leave was $8,664,000 and $8,206,000, respectively.

Classification of Revenues

The University has classified its revenues as either operating or nonoperating revenues.

Operating revenues include activities that have the characteristics of exchange transactions such as student tuition and fees, net of scholarship discounts and allowances; sales and services of auxiliary enterprises, net of scholarship allowances; most federal, state and local grants and contracts; and, hospital patient service revenues, net of allowances for contractual adjustments and doubtful accounts.

Non operating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34, such as state appropriations, investment income and gifts. Gifts to the endowment fund are classified as other nonoperating revenues.

Gifts and Pledges

Pledges of financial support from organizations and individuals representing and unconditional promise to give are recognized in the financial statements once all eligibility requirements, including time requirements, have been met. In the absence of such promise, revenue is recognized when the gift is received. Endowment pledges generally do not meet eligibility requirements, as defined by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and are not recorded as assets until the related gift has been received.

Unconditional promises that are expected to be collected in future years are recorded at the present value of the estimated future cash flows.

1. Reporting Entity and Summary of Significant Accounting Policies (continued)

Gifts and Pledges (continued)

During the current year, the University received the third payment of $5,000,000 of an award from the National Center of Minority Health Disparities (NCMHD) amounting to $17,925,684, to establish a Health Services Research Center within the University of Puerto Rico's School of Medicine. The purpose of this Center is to strengthen and increase the diversity of the biomedical and behavioral workforce for the 21st century.

As part of the agreement, the University has to maintain the principal invested for at least five years; therefore, it was classified as a term endowment fund. The University received other miscellaneous endowment gifts during the year.

Grants and Contracts

The University has been awarded grants and contracts for which the funds have not been received or expenditures made for the purpose specified in the award. These awards have not been reflected in the financial statements, but represent commitments of sponsors to provide funds for specific research or training projects. For grants that have allowable cost provisions, the revenue will be recognized as the related expenditures are made. For grants with work completion requirements, the revenue is recognized as the work is completed and for grants without either of the above requirements, the revenue is recognized as it is received.

2. Cash and Cash Equivalents

As of June 30, 2005 and 2004, cash equivalents of approximately $25,757,000 and $65,898,000 respectively, consist of certificates of deposit and time deposits.

All the operating cash of the University and its Retirement System (the System) is pooled into one bank account. Cash balances by funds represent the cash that is allocated to each fund of the University.

The University is authorized to deposit only in institutions approved by the Department of the Treasury of the Commonwealth of Puerto Rico (Treasury) and such deposits are maintained in separate bank accounts in the name of the University. Such authorized depositories, except for the Government Development Bank for Puerto Rico (GDB) and the Economic Development Bank for Puerto Rico (EDB), collateralize the uninsured deposits with securities that are pledged with the Department of the Treasury.

No collateral is required to be maintained for deposits in the GDB and EDB, both public corporations of the Commonwealth of Puerto Rico.

2. Cash and Cash Equivalents (continued)

As of June 30, 2005 and 2004, the carrying value of cash and cash equivalents amounted to approximately $35,572,000 and $56,828,000 respectively, and the cash deposited in the banks amounted to $46,923,000 and $70,938,000 respectively.

3. Investments

The University's investments held at June 30, 2005 and 2004 are summarized in the following table:

	2005	2004
Certificates of deposit	**$ 7,457,224**	$ 4,536,924
Government agency securities	**56,456,176**	51,799,023
Corporate bonds and preferred stock	**11,104,374**	10,257,849
Common stock and convertibles	**59,793,072**	51,879,671
Other	**-**	350,000
	$ 134,810,846	$ 118,823,467

The custody of these investments is held by the trust treatment of a commercial bank in the name of the University and the portfolio is managed by a brokerage firm.

The University is authorized to invest a percentage of total assets, with certain limitations, in the following types of investments; not less than 20% and no more than 80% in fixed income securities, not less than 20% and no more than 80% in equity securities. No international equity, private equity and on non-U.S. income securities investments are held by the University.

Credit Risk

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Investments issued or explicitly guaranteed by the United States government are excluded. As of June 30, 2005, the University's credit quality distribution for securities was as follows:

	Carrying Value	Moody's Ratings
U.S. Treasury Notes	$ 15,555,062	AAA
Corporate Bonds	11,104,384	AA

3. Investments (continued)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes to market interest rates. As of June 30, 2005, the weighted average maturity by investment type in each fund follows:

Investment Type	Maturities	Amount
U.S. Treasury Notes	April 2008 - July 2032	$ 6,913,802
U.S. Treasury Notes	March 2007 - July 2032	422,114
U.S. Treasury Notes	November 2008 - July 2032	133,411
U.S. Treasury Notes	April 2008 - July 2032	6,969,055
U.S. Treasury Notes	November 2008 - April 2010	26,668
U.S. Treasury Notes	August 2008 - July 2032	1,090,012
Corporate Bonds	January 2006 - May 2033	4,694,744
Corporate Bonds	January 2006 - March 2033	315,522
Corporate Bonds	January 2006 - March 2033	130,577
Corporate Bonds	January 2006 - May 2033	4,757,751
Corporate Bonds	October 2013 - October 2030	11,963
Corporate Bonds	January 2006 - May 2033	1,193,827
		$ 26,659,446

4. Accounts Receivable

Accounts receivable as of June 30 are as follows:

	2005	2004
Commonwealth of Puerto Rico appropriations, grants and contracts	**$ 60,341,238**	$ 93,132,075
Due from Federal government	**40,857,570**	31,410,284
Due from Medical Plans	**45,203,075**	39,863,035
Due from Servicios Médicos Universitarios, Inc.	**24,646,756**	20,946,756
Other	**67,520,356**	51,567,608
	238,568,995	236,919,758
Less allowance for doubtful accounts	**96,379,608**	75,841,858
Accounts receivable, net	**$ 142,189,387**	$ 161,077,900

On September 7, 2004, the legislature of Puerto Rico approved a resolution to pay $94,710,382 to the University on behalf of the Puerto Rico Department of Health and the Commonwealth of Puerto Rico, over the course of ten years. As of June 30, 2005 the University has received $7,570,127 from this amount. The remaining balance is going to be received as follows:

Fiscal Year	Amount
2005-2006	$ 15,570,127
2006-2007	15,570,127
2007-2008	15,570,127
2008-2009	7,570,127
2009-2010	7,570,127
2010-2011	7,570,127
2011-2012	8,000,000
2012-2013	8,000,000
2013-2014	1,719,493
	$ 87,140,255

5. Capital Assets

Changes in capital assets for the year ended June 30, 2005 and 2004 are as follows:

	2005				
	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Capital assets not being depreciated:					
Land	$ 32,965,504	$ -	$ -	$ -	$ 32,965,504
Construction - in progress	117,183,191	50,431,777	(16,163,234)	(1,013,274)	150,438,460
	150,148,695	50,431,777	(16,163,234)	(1,013,274)	183,403,964
Other capital assets:					
Land improvements	30,514,724	-	-	-	30,514,724
Building, fixed equipment, improvements and infraestructure	566,661,328	-	15,285,066	-	581,946,394
Equipment and library materials	184,657,207	20,089,510	878,168	(8,686,426)	196,938,459
	781,833,259	20,089,510	16,163,234	(8,686,426)	809,399,577
Less accumulated drepreciation for:					
Land improvements	(10,211,382)	(1,252,099)	-	-	(11,463,481)
Buildings, fixed equipment, improvements and infraestructure	(196,029,115)	(14,690,372)	-	-	(210,719,487)
Equipment and library materials	(134,409,585)	(13,411,474)	-	7,103,613	(140,717,446)
	(340,650,082)	(29,353,945)	-	7,103,613	(362,900,414)
Other capital assets, net	441,183,177	(9,264,435)	16,163,234	(1,582,813)	446,499,163
Capital assets, net	$ 591,331,872	$ 41,167,342	$ -	$ (2,596,087)	$ 629,903,127

5. Capital Assets (continued)

	2004				
	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Capital assets not being depreciated:					
Land	$ 32,965,504	$ -	$ -	$ -	$ 32,965,504
Construction - in progress	147,986,260	41,812,751	(70,982,665)	(1,633,155)	117,183,191
	180,951,764	41,812,751	(70,982,665)	(1,633,155)	150,148,695
Other capital assets:					
Land improvements	29,140,159	-	1,374,565	-	30,514,724
Building, fixed equipment, improvements and infraestructure	495,434,471	1,834,631	69,419,494	(27,268)	566,661,328
Equipment and library materials	175,215,625	17,438,105	188,606	(8,185,129)	184,657,207
	699,790,255	19,272,736	70,982,665	(8,212,397)	781,833,259
Less accumulated drepreciation for:					
Land improvements	(9,495,235)	(716,147)	-	-	(10,211,382)
Buildings, fixed equipment, improvements and infraestructure	(183,283,414)	(12,745,701)	-	-	(196,029,115)
Equipment and library materials	(119,358,567)	(20,804,416)	-	5,753,398	(134,409,585)
	(312,137,216)	(34,266,264)	-	5,753,398	(340,650,082)
Other capital assets, net	387,653,039	(14,993,528)	70,982,665	(2,458,999)	441,183,177
Capital assets, net	$ 568,604,803	$ 26,819,223	$ -	$ (4,092,154)	$ 591,331,872

Project in Process – Discretely Presented Component Unit

Project in process of Desarrollos Universitarios, Inc. at March 31, 2005 and 2004 consist of:

	2005	2004
Construction, professional services and project management	**$ 71,492,429**	$ 65,558,257
Interest capitalized, net of interest and dividends earned from restricted funds of $9,122,543 and $8,514,412	**9,262,994**	5,407,707
Total	**$ 80,755,423**	$ 70,965,964

6. Lines of Credit

As of June 30, 2005, the University has available two line of credit agreements with GDB for the total authorized amounts of $100,000,000 and $60,000,000. Advances under these agreements, which bear a variable interest rates and are payable in a monthly and annual basis, respectively, amounted to $45,701,010 and $2,261,559 at June 30, 2005. The line of credit of $60,000,000 is guaranteed by the Commonwealth of Puerto Rico.

7. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2005 and 2004 are as follows:

2005

	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt							
Notes payable	$ 16,182,231	$ 32,011,113	$ (230,775)	$ -	$ 47,962,569	$ 45,701,010	$ 2,261,559
Bonds payable	413,184,153	-	(17,255,000)	2,270,360	398,199,513	18,200,000	379,999,513
Total long-term	$ 429,366,384	$ 32,011,113	$ (17,485,775)	$ 2,270,360	$ 446,162,082	$ 63,901,010	$ 382,261,072
Other long-term liabilities							
Deferred compensation payable	$ 39,646,387	$ 5,928,913	$ -	$ -	$ 45,575,300	$ -	$ 45,575,300
Claims liability	13,598,042	7,000,000	(338,042)	-	20,260,000	2,000,000	18,260,000
Compensated absences	115,425,464	12,406,881	-	-	127,832,345	20,943,548	106,888,797
Total other long-term liabilities	$ 168,669,893	$ 25,335,794	$ (338,042)	$ -	$ 193,667,645	$ 22,943,548	$ 170,724,097

2004

	Beginning Balance	Additions	Reductions	Other	Ending Balance	Less Due Within One Year	Noncurrent Liabilities
Long-term debt							
Notes payable	$ 508,195	$ 15,951,456	$ (277,422)	$ -	$ 16,182,231	$ 14,276,864	$ 1,905,367
Bonds payable	432,285,012	-	(21,170,000)	2,069,142	413,184,153	17,255,000	395,929,153
Total long-term	$ 432,793,207	$ 15,951,456	$ (21,447,422)	$ 2,069,142	$ 429,366,384	$ 31,531,864	$ 397,834,520
Other long-term liabilities							
Deferred compensation payable	$ 32,767,691	$ 6,878,696	$ -	$ -	$ 39,646,387	$ -	$ 39,646,387
Claims liability	13,358,265	3,111,018	(2,871,241)	-	13,598,042	3,500,000	10,098,042
Compensated absences	107,395,105	8,030,359	-	-	115,425,464	19,145,980	96,279,484
Total other long-term liabilities	$ 153,521,061	$ 18,020,073	$ (2,871,241)	$ -	$ 168,669,893	$ 22,645,980	$ 146,023,913

Bonds payable are further disclosed in Note 8.

8. Bonds Payable

A. Bonds

The University has issued revenue bonds designated as "University System Revenue Bonds", the proceeds of which have been used mainly to finance new activities in connection with its educational facilities construction program and to cancel and refinance previous debts incurred. The following is the balance of bonds payable as of June 30, 2005:

Series	Balance as of June 30, 2005	Anual Interest Rate (%)	Due Date
C - Serial	$ 929,000	3.00%	1972-2011
D - Serial	1,208,000	3.75%	1972-2011
F - Term	12,225,000	5.50%	2012
M - Serial	18,305,000	4.35-5.45%	1996-2009
M - Term	127,215,000	5.25-5.45%	2015-2025
N - Serial	27,850,000	4.35-5.45%	1996-2008
N - Capital Appreciation Serial Bonds	51,980,000	5.6-5.75%	2009-2013
O - Serial	81,025,000	4.5-3.75%	2001-2020
O - Term	101,905,000	5.38%	2030
	422,642,000		
Less unamortized bond discount	(10,893,024)		
Plus unaccreted premium	1,213,158		
Less future appreciated principal	(14,762,621)		
	$ 398,199,513		

Capital Appreciation Serial Bonds interest accrues semi-annually and is added to the principal.

8. Bonds Payable (continued)

B. Debt Service Requirement

	Principal	Interest	Total
2006	$ 18,200,000	$ 19,864,180	$ 38,064,180
2007	19,210,000	18,854,332	38,064,332
2008	20,280,000	17,784,858	38,064,858
2009 to 2013	113,172,000	108,025,133	221,197,133
2014 to 2018	66,505,000	60,554,138	127,059,138
2019 to 2023	86,375,000	40,688,538	127,063,538
2024 to 2028	74,045,000	17,094,904	91,139,904
2029 to 2030	24,855,000	2,022,000	26,877,000
	$ 422,642,000	$ 284,888,083	$ 707,530,083

C. Pledged Revenues

The bonds are general obligations of the University and are collateralized by the pledge of, and a first charge on, all revenues derived or to be derived by the University, except for appropriations and contributions, as defined in the Trust Agreement governing the bonds issued. In the event that the pledged revenues are insufficient to pay the principal of and the interest on, the bonds, the University agrees to provide any additional required monies from other funds available to the University for such purposes, including funds appropriated by the Commonwealth of Puerto Rico. The revenues pledged were as follows for the year ended June 30, 2005:

Pledged Revenues:	**June 30, 2005**	**June 30, 2004**
Tuition and other fees collected	**$ 53,791,456**	$ 55,431,021
Student fees collected	**5,024,000**	5,109,364
Rental and other charges received for the right of use and occupancy of the facilities in the University system	**1,142,215**	1,209,430
Bookstore receipts (gross sales less cost of books and supplies sold)	**720,050**	456,461
Interest on investment of University funds, excluding funds invested pursuant to Article VI of the Trust Agreement	**957,054**	812,034
Funds paid to the University in respect to overhead allowance on federal research projects	**16,732,754**	15,317,430
Other income	**28,606,408**	28,501,876
	$ 106,973,937	$ 106,837,616

8. Bonds Payable (continued)

C. Pledged Revenues (continued)

Interest earned on investments in the sinking fund reserve account amounted to approximately $846,000 and $377,000 for the years ended June 30, 2005 and 2004, respectively.

The University is required to maintain a sinking fund and construction fund as described in the following paragraphs:

The funds for retirement of indebtedness consist of a sinking fund which includes three separate accounts designated Bond Service Account, Redemption Account and Reserve Account. The Trustee shall, upon the receipt of the pledged revenues, make deposits to the credit of the following accounts in the amounts specified and in the following order:

Bond Service Account - such amount thereof as may be required to make the amount then to its credit equal to the interest then due, or to become due, within the next ensuing six (6) months on the bonds of each series then outstanding, and the amount of principal of the serial bonds of each series then due, or to become due, within the next ensuing twelve (12) months.

Redemption Account - such amount, if any, after making the deposit to the Bond Service Account, as may be required to make the amount then to its credit equal to the amortization requirements, if any, for the fiscal year in which such deposit is made for the term bonds of each series then outstanding plus redemption premiums, if any.

Reserve Account - such amount, if any, after making the deposit to the above accounts as may be required to make the amount then to its credit equal to the maximum principal and interest (less any federal debt service grant payments) requirements for any year thereafter, on account of all bonds then outstanding.

Monies in the Bond Service Account and the Redemption Account shall, as nearly as may be practicable, be continuously invested and reinvested in direct obligations of, or obligations, the principal of and interest on which are unconditionally guaranteed by the United States Government. Monies in the Reserve Account may be invested in a broader range of investments including interest bearing bank accounts, federal agency obligations, repurchase agreements, commercial paper and other highly rated obligations.

D. Bonds Arbitrage

During fiscal year 2005 the Government Development Bank performed an arbitrage test. The preliminary results of the test showed a negative arbitrage.

8. Bonds Payable (continued)

E. Bonds Payable – Discretely Presented Component Unit

On December 21, 2000, AFICA issued, on behalf of Desarrollos Universitarios, Inc., Educational Facilities Revenue Bonds, 2000 Series A, in the amount of $86,735,000. The bonds were issued to (i) finance the development, construction and equipment of Plaza Universitaria Project (the Projects), (ii) repay a portion of certain advances made by the Government Development Bank for Puerto Rico under a line of credit facility for the purpose of paying certain costs of the development and construction of the Projects, (iii) make a deposit to the Debt Service Reserve fund and, (iv) pay the costs and expenses incurred in connection with the issuance and sale of bonds. The principal and interest on the bonds are insured by a financial guaranty insurance policy issued by MBIA Insurance Corporation, and by the assignment of the lease agreement with the University.

Bonds payable at March 31, 2005 and 2004 consist of:

Description	Interest Rate	Maturity	2005 Face Amount	2004 Face Amount
Serial Bonds	5.00%	July 1, 2004	**$ -**	$ 1,295,000
Serial Bonds	4.00%	July 1, 2005	**1,360,000**	1,360,000
Serial Bonds	5.00%	July 1, 2006	**1,415,000**	1,415,000
Serial Bonds	4.00%	July 1, 2007	**1,485,000**	1,485,000
Serial Bonds	5.00%	July 1, 2008	**1,545,000**	1,545,000
Serial Bonds	4.13%	July 1, 2009	**1,620,000**	1,620,000
Serial Bonds	4.25%	July 1, 2010	**1,685,000**	1,685,000
Serial Bonds	5.63%	July 1, 2011	**1,760,000**	1,760,000
Serial Bonds	5.63%	July 1, 2012	**1,860,000**	1,860,000
Serial Bonds	5.63%	July 1, 2013	**1,960,000**	1,960,000
Serial Bonds	5.63%	July 1, 2014	**2,075,000**	2,075,000
Serial Bonds	5.63%	July 1, 2015	**2,190,000**	2,190,000
Serial Bonds	5.63%	July 1, 2016	**2,315,000**	2,315,000
Serial Bonds	5.63%	July 1, 2017	**2,445,000**	2,445,000
Serial Bonds	5.63%	July 1, 2018	**2,580,000**	2,580,000
Serial Bonds	5.63%	July 1, 2019	**2,725,000**	2,725,000
Serial Bonds	5.00%	July 1, 2020	**2,880,000**	2,880,000
Serial Bonds	5.00%	July 1, 2021	**3,020,000**	3,020,000
Serial Bonds	5.00%	July 1, 2033	**50,520,000**	50,520,000
Total			**$ 85,440,000**	$ 86,735,000

8. Bonds Payable (continued)

E. Bonds Payable – Discretely Presented Component Unit (continued)

Interest on the bonds is payable each January 1 and July 1, commencing on July 1, 2001. Bonds maturing after July 1, 2010 may be redeemed, at the option of the University in whole or in part, at a redemption price equal to 100% of the principal amount plus accrued interest, without premium. In addition, term bonds are subject to mandatory redemption in part commencing on July 1, 2022 to the extent of the sinking fund requirement for said bonds set forth below at a redemption price equal to 100% of the principal amount thereof plus accrued interest.

Redemption Period	Amount
July 1, 2022	$ 3,175,000
July 1, 2023	3,330,000
July 1, 2024	3,500,000
July 1, 2025	3,675,000
July 1, 2026	3,855,000
July 1, 2027	4,050,000
July 1, 2028	4,255,000
July 1, 2029	4,465,000
July 1, 2030	4,690,000
July 1, 2031	4,925,000
July 1, 2032	5,170,000
July 1, 2033	5,430,000
	$ 50,520,000

9. Commitments and Contingent Liabilities

A. Insurance

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Through January 1993 the University was insured under claims-made insurance policies with respect to medical malpractice risks for $250,000 per occurrence up to an annual aggregate of $500,000. Subsequent to such date, the University was unable to obtain insurance at a cost it considered to be economically justifiable, consequently, the University is now self-insured for such risks. Under Law Number 98 of August 24, 1994, the responsibility of the University is limited to a maximum amount of $75,000 per person, or $150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risk liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend upon such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. Changes in the claims liability amount in fiscal year 2005 were:

Claims payable - July 1	$	13,598,042
Incurred claims and changes in estimates		27,298,905
Payments for claims and adjustments expenses		(20,636,947)
Claims payable - June 30	$	20,260,000

The University continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

B. Federal Assistance Programs

The University participates in a number of federal financial assistance programs. These programs are subject to audits in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, or to compliance audits by grantor agencies. The resolution of certain previously identified questioned costs has not occurred. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time, although the University expects such amounts, if any, to be immaterial.

9. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units

Servicios Médicos Universitarios, Inc. (the Hospital) is a nonprofit corporation organized to operate and administer healthcare units located in Carolina. These facilities were acquired by the University and include land, building and medical equipment.

The Hospital entered into a loan agreement (the Agreement) with the Government Development Bank for Puerto Rico (GDB) for an aggregate principal amount not to exceed $17,000,000. As part of the Agreement, the University (the Guarantor) agreed to guaranty payment obligations.

On July 18, 2001, the Board of Trustees approved to amend the Working Capital Loan to $15,367,611 and to decrease the Improvement Loan to $1,632,389. The amendment was effective on August 1, 2001. In addition, the Guarantor will pay GDB, on the first day of July and January of each year, the balance of interest due and outstanding by the Hospital.

Scheduled principal repayments on long-term debt and capital lease obligations for the next five years and thereafter are as follows:

	Long-Term Debt	Capital Leases
2006	$ 15,367,611	$ 300,087
2007	-	-
2008	-	-
2009	-	-
2010	-	-
Thereafter	1,632,389	-
	17,000,000	300,087
Less: amount representing interest under capital lease obligations	-	21,103
	$ 17,000,000	$ 278,984

Total interest charged to operations under the aforementioned leases was approximately $29,500 and $30,000 in 2005 and 2004, respectively.

9. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units (continued)

Desarrollos Universitarios, Inc. (the Company) was incorporated on October 2, 1996. The Company is a non-profit corporation, with the sole purpose of developing, constructing and operating academic, residential, administrative, office, commercial and maintenance facilities (Plaza Universitaria) for use by students, faculty members, administrators, employees, visitors, invitees, and other members of or persons and entities related to or conducting business with the University community, or other activities conducted in such facility.

On May 11, 2000 the University's Board of Trustees ratified a Memorandum of Agreement (the Agreement) to establish a contractual agreement between the University and the Company. The Agreement, dated May 22, 1998, states among other things the following: (1) the University will lease to, or otherwise grant to, the Company the right for the long-term use of the land, for the sole purpose of developing, constructing and operating Plaza Universitaria, (2) the Company shall finance the development of Plaza Universitaria from AFICA Bond proceeds and/or line credit and/or any other structure or credit facility, (3) the Company will own the Plaza Universitaria improvements and will lease them exclusively to the University, during the life of the AFICA Bonds, (4) the University shall have the right to prepay or refinance the Bonds at any time, consistent with the restrictions on refinancing contained in the financing documents, (5) upon the payment or prepayment in full of all the AFICA Bonds, the lease on the land shall terminate and the University shall become, *ipso facto,* owner of all the Plaza Universitaria improvements, without the need or obligation to make any additional payment of any kind (other than any "bargain purchase" payment as may be required under the project documents), and (6) rental payments (lease payments) from the University shall have a fixed component and a variable component. The fixed component shall be in an amount sufficient to guarantee to bondholders the payment of principal and interest on the AFICA Bonds as may be established in the financing documents, and will be pledged to guarantee such payments. The variable component of the lease payments will be used to cover operating, maintenance, administrative, management, and other fees and costs, which will be established periodically and reviewed annually between the parties, as well as such amounts for reserves and special funds, which may be required under the financing documents related to the bond issue.

On December 21, 2000, the University entered into a lease agreement with the Company in which the University agreed to pay directly to a trustee for the account of the Company, the basic lease payments (denominated into components of principal and interest) on or before the twenty-fifth (25) day of each month. As of June 30, 2005 and 2004, the University had paid in advance a total of $21,322,000 and $16,096,000, respectively, for these purposes and such amounts have been recorded in the accompanying statements of net assets as prepaid expenses and other assets.

9. Commitments and Contingent Liabilities (continued)

C. Discretely Presented Component Units (continued)

Future minimum annual lease payments under this agreement at June 30, 2005 are: $5,702,000 in 2006; $5,701,000 in 2007; $5,701,000 in 2008; $5,700,000 in 2009; $5,698,000 in 2010; and $132,528,000 thereafter.

In October 2003, Plaza Universitaria Project's general contractor submitted a claim for extended overhead (field and main office) and subsequently a Proposal for Settlement for an amount exceeding $10 million. It is the Company's legal counsel's opinion that some of the allegations are invalid under the terms of the existing contract and that the general contractor has already been compensated for some of the claimed amounts by Company approved change orders. Management of the Company believes, based on the advice of counsel, that there is a minimal financial exposure to the Company in connection with this claim.

10. University of Puerto Rico Retirement System

General

The System is a single-employer defined benefit pension plan that covers all employees of the University of Puerto Rico (the University) with the exception of hourly, temporary, part-time, contract and substitute employees, and visiting professors. It is qualified and exempt from Puerto Rico and United States taxes.

Membership consisted of the following as of June 30, 2005 and 2004:

	2005	**2004**
Retirees and beneficiaries receiving benefits	**6,408**	6,317
Terminated plan members entitle to but no yet receiving benefits	**348**	324
Terminated non-vested plan members entitled to return on their contributions	**7,041**	6,945
Active plan members	**12,677**	12,484
Total	**26,474**	26,070

10. University of Puerto Rico Retirement System (continued)

Plan Amendments

Effective July 1, 1999, the Plan was amended by establishing Certification 128, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1995, with a monthly minimum of $10.

Effective July 1, 1995, the Plan was amended by establishing Certification 194, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1992, with a monthly minimum of $10.

Effective July 1, 2004, the Plan was amended by establishing Certification 130, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 2001, with a monthly minimum of $10.

Effective July 1, 2002, the Plan was amended, by establishing Certification 139, to offer participants an increase from $50,000 to $60,000 in the maximum salary subject to withholding contribution. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding $50,000 and up to a maximum of $60,000 plus 8% interest. Also, effective July 1, 2002, maximum salary basis will increase automatically 3% every two years.

Effective July 1, 2001, the Plan was amended by establishing Certification 140, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1998, with a monthly minimum of $10.

Effective July 1, 1998, the Plan was amended by establishing Certification 94, to offer participants an increase from $35,000 to $50,000 in the maximum salary subject to withholding contributions. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding $35,000 and up to a maximum of $50,000 plus 8% interest. Effective July 1, 1998, all new participants contribute 9% of their salary up to $50,000.

In addition, the maximum annual compensation for those participants who had not completed 20 years of service by July 1, 1979 is $35,000. Also, the minimum pension is $250 a month. Finally, the reduction for commencement of pension benefits prior to age 65 is 1/3% per month for participants who had not completed 20 years of service by July 1, 1979 and elected Certification 55, and for participants hired on or after January 1, 1990.

10. University of Puerto Rico Retirement System (continued)

Contributions and Funding Policy

The contribution requirements of plan members and the University are established and may be amended by the Board of Trustees. Plan members are required to contribute as follows:

Members who elect Certification No. 139: 11% of monthly compensation up to $5,000

Members who have not completed 20 years of service by July 1, 1979:

- If full supplement is elected: 7% of monthly compensation up to $2,625
- If full supplement is not elected: 5% of monthly compensation up to $2,625
- If Certification 94 is elected: 9% of monthly compensation up to $4,500

Members who have completed 20 years of service by July 1, 1979:

- If full supplement is elected: 7% of monthly compensation
- If full supplement is not elected: 4% of monthly compensation up to $350, plus 6.5% of the excess

Members who have not completed 20 years of service by July 1, 1979 and elect Certification 55:

- If full supplement is elected: 7% of monthly compensation up to $2,625
- If full supplement is not elected: 4% of monthly compensation up to $350, plus 6.5% of the excess up to $2,625
- If Certification 94 is elected: 9% of monthly compensation up to $4,167

Members who are hired between January 1, 1990 and June 30, 1998:

- 8% of monthly compensation up to $2,625 or,
- If Certification 94 is elected: 9% of monthly compensation up to $4,167

Members who are hired on or after July 1, 1998:

- 9% of monthly compensation up to $4,167

The University is supposed to contribute at an actuarially determined rate; the rate as of June 30, 2005 and 2004 was 18.4% and 16.2% respectively, of annual covered payroll. The actuarially determined employer contribution rate takes into account payment of administrative expenses. Therefore, administrative expenses are paid out of the trust fund. The University contributed 15% and 14% of participants' payroll in 2005 and 2004, respectively.

10. University of Puerto Rico Retirement System (continued)

Contributions and Funding Policy

The contributions of the University were originally designed to fund, together with the contributions of the members, the current service cost on a current basis and the estimated accrued benefit cost attributable to qualifying service prior to the establishment of the System over a forty-year period, but as a result of increasing benefits without a correlative increase in employer's contributions, they fall short of accomplishing the necessary funding.

Retirement Benefits

The System provides retirement, disability and death benefits to plan members and beneficiaries. Cost-of-living adjustments are provided to members and beneficiaries at the discretion of the Board of Trustees of the University of Puerto Rico (Board of Trustees), formerly known as the Council on Higher Education of the University of Puerto Rico. Article XIII of the Rules and Regulations of the University of Puerto Rico Retirement System as amended effective July 1, 1973 assigns the authority to establish and amend benefit provisions to the Board of Trustees.

Participants who have completed 20 years of service by July 1, 1979 are entitled to annual retirement benefits at any age after 30 years of service. Otherwise, participants are entitled to annual retirement benefits at age 55 after 30 years of service. Participants may elect to receive their retirement benefits at age 58 after 10 years of service, or at age 55 after 25 years of service.

The amount of service retirement annuity is as follows:

- For all members except those who have completed 20 years of service by July 1, 1979:

  - Before age 65 - for members with at least 30 years of service: 75% of average compensation. Amount is reduced by ½% for each month the member is under age 58 (Certification 37) and 55 (Certification 55), at time annuity begins.

  - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for the member with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year. Amount is reduced by ½% for each month the member is under age 58 at time annuity begins.

  - After age 65 - if the member elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by ½% of average compensation not in excess of Social Security wage base in effect at retirement for each year of service. If the member had less than 30 years of service and was under age 58 at the beginning date, adjustment is made before application of ½% reduction per month under age 58.

10. University of Puerto Rico Retirement System (continued)

Retirement Benefits (continued)

- For those members who have completed 20 years of service by July 1, 1979:

  - Before age 65 - for members with at least 30 years of service: 75% of average compensation if age 55 at beginning date; 65% if under age 55. If the member completed 30 years of service before July 1973, the annuity is increased by 2% of average compensation for each year of service beyond 30 and before July 1973, but to not more than 85% of average compensation.

  - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for members with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to maximum of 1.95% per year. Amount is reduced by ½% for each month the member is under age 58 at the time the annuity begins.

  - At age 65 - if member elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by ½% of first $350 of average compensation for each year of service but not by more than primary Social Security benefit. If the member had less than 30 years of service and was under age 58 at beginning date, adjustment is made before application of ½% reduction per month under age 58.

- For all members who have not completed 20 years of service by July 1, 1979 and elect Certification 55, and for those hired on or after January 1, 1990:

  - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for members with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year.

  - Before age 65 - for members with at least 30 years of service: 75% of average compensation for participants with at least 55 years of age at retirement date. Amount reduced by ½% for each month the member is under age 55 at time annuity begins.

  - Age 65 - if member elected full supplement, annuity is the same as before age 65. Otherwise, annuity is reduced by ½% of average compensation at time of retirement multiplied by years of service.

    - Minimum Annuity - $250 per month - if a member terminates before rendering 10 years of service, the right to receive the portion of his accumulated plan benefits attributable to the University's contributions is forfeited. However, the employee is entitled to receive, in a lump-sum payment, the value of his accumulated contributions.

10. University of Puerto Rico Retirement System (continued)

Retirement Benefits (continued)

- If a member terminates after rendering 10 years of service, and does not withdraw his contributions, the member receives a retirement annuity payable beginning at age 60 based on the applicable benefit formula.

- Refund may also be obtained after 10 years of service, but the vested benefit is lost.

• **Disability Benefits -** employees who become disabled receive annual disability benefits regardless of service if disability is due to occupational causes or after 10 years of service if disability is due to non-occupational causes. If the employee is also eligible for a retirement annuity, the benefit payable is the higher of the two. Disability benefits are paid as follows:

  - Before age 65 - if service related, 50% of final salary. If not service related, 30% of average compensation plus additional 1% for each year of service over 10.

  - After age 65 - reduced to amount payable as retirement annuity, if that amount is less than disability retirement annuity, but reduced annuity plus primary Social Security benefit may not be less than original disability annuity.

Death Benefits:

• Pre-retirement death benefit - if the death of an employee is service related, a death benefit equal to 50% of the final annual salary plus $120 ($240 if widow not receiving benefit) per year for each child under age 18 (21 if at school) is paid to the employee's beneficiaries. Maximum family benefit is 75% of the employee's final annual salary. If death is non-service related, a lump-sum is paid equal to the employee's contributions plus one year's final salary, but not less than $6,000.

• Post retirement death benefits - employee's contributions are refunded to the extent that they exceed retirement payments already made, unless reversionary annuity was elected. Minimum payment is $600. In addition, 50% of retirement annuity is payable to surviving spouse until death or remarriage or until they become eligible for Social Security benefits. Minimum annuity, $75 per month, maximum annuity, $150 per month.

Christmas Bonus:

• A $400 annual bonus is given to all retiree plan members.

11. Post-Retirement Benefits

In addition to the pension benefits described in Note 10, the University provides post-retirement health care benefits and a Christmas bonus for its retired employees in accordance with law. Substantially all of the employees may become eligible for these benefits if they reach normal retirement age while working for the University. Health care benefits are provided through insurance companies whose premiums are paid by the retiree and by the University up to maximum of $125 per month for each retiree. During the years ended June 30, 2005, the payments of health care benefits amounted to $7,778,000. The Christmas bonus paid to the retired employees during the years ended June 30, 2005 and 2004 were $400 per retiree and the total amounts were $2,476,650 and $2,444,114, respectively. These benefits are recorded as expenses when granted and paid. The plan covers approximately 6,408 retirees.

12. Going Concern - Discretely Presented Component Unit

Since the Hospital commenced operations, it has experienced significant operating losses having an accumulated net assets deficiency of approximately $51,425,000 at June 30, 2005. The Hospital has received advances from the University to cover its cash needs from operations. Most of these accumulated losses are mainly related to the fact that, as a former public hospital operated by the Department of Health, it provides a significant amount of services to indigent population for which the Hospital does not obtain a payment. Most of these patients are indigent persons not subscribed to the Health Reform Program are aliens without medical insurance coverage, among others. The medical services provided to these persons were supposed to be paid to the Hospital by the Puerto Rico Department of Health. However, since the beginning of the operations of the Hospital, the Department of Health has been unable to pay for such services. As shown in the accompanying financial statements, the Hospital has accumulated losses for uncollectible accounts receivable in the approximate amount of $29,174,000.

The Hospital's management believes that all these factors had a material impact in the Hospital's results of operations during its years of operations and consequently in the accumulated deficit at June 30, 2005.

The Hospital's management with the assistance of the University of Puerto Rico's administration continues implementing a management plan toward its operational activities as well as the Hospital's ability to get cash to comply with its current obligations.

Among the matters included in such management plan are the following:

- Extension of the medical privileges in the Hospital to faculty members within the Hospital's primary and secondary market area.
- Development of new business within the Hospital's building, for example space rentals for physicians and others.
- Marketing of the Ob Gyn and pediatrics services.

12. Going Concern - Discretely Presented Component Unit (continued)

- Marketing of the ophthalmology services, including a new physician that has a specialization in cornea diagnosis and treatment.
- Revaluation of the contract agreements with the anesthesiologists and radiologists, to share the costs of those services.
- More aggressive negotiation with medical insurance to increase the per diem rates.

Among the alternatives, the Hospital has to deal with its fiscal difficulties and has publicly discussing the possibility to sell the Hospital's facilities.

The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded assets amounts or the amounts and classifications of liabilities that might be necessary, should the Hospital be unable to continue as a going concern or in the event of any disposition of the Hospital's assets through a sale or by other means.

13. Functional Information

The University's operating expenses by functional classification were as follows:

Functional classification	Salaries and Benefits	Supplies and Other Services	Scholarship and Fellowship	Utilities	Depreciation	Other Expenditures	Total
Instruction	$ 334,968,365	$ 19,067,166	$ 12,307,580	$ 1,185,011	$ -	$ 173,392	**$ 367,701,513**
Research	62,412,211	22,049,800	9,067,252	502,357	-	4,002,415	**98,034,034**
Public service	43,852,678	9,534,958	2,392,871	169,833	-	72,001	**56,022,340**
Academic support	67,299,111	14,547,307	3,672,593	60,474	-	36,000	**85,615,486**
Student service	37,379,622	7,383,156	649,844	1,435	-	66,241	**45,480,298**
Institutional support	128,855,178	30,374,022	369,132	2,519,873	-	578,693	**162,696,899**
Oper & Maintenance	65,920,485	7,001,842	26,942	28,396,986	-	183,732	**101,529,987**
Student Aid	1,569,980	643,967	122,554,307	-	-	-	**124,768,254**
Patient Service	40,686,479	1,649,465	33,565	6,515	-	15,023	**42,391,047**
Auxiliary Enterprises	4,536,267	5,730,835	31,935	310,062	-	-	**10,609,100**
Depreciation	-	-	-	-	29,353,945	-	**29,353,945**
Other	-	-	-	-	-	57,869,781	**57,869,781**
	$ 787,480,375	**$ 117,982,519**	**$ 151,106,021**	**$ 33,152,547**	**$ 29,353,945**	**$ 62,997,277**	**$ 1,182,072,684**

14. Significant New Accounting Pronouncements

In November 2003 the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries. This statement will be effective for the University for fiscal year ending June 30, 2006.

In April 2004 the GASB issued Statement No. 43, *Financial Reporting for Post employment Benefit Plans Other Than Pension Plans*. This Statement establishes uniform financial reporting standards for OPEB plans and supersedes the interim guidance included in Statement No. 26, *Financial Reporting for Post employment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, with modifications to reflect differences between pension plans and OPEB plans. This statement will be effective as follows:

> The requirements of this Statement for OPEB plan reporting are effective one year prior to the effective date of Statement 45 for the employer (single-employer plan) or for the largest participating employer in the plan (multiple-employer plan). The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:
>
> - Plans in which the sole or largest employer is a phase 1 government—with annual revenues of $100 million or more—are required to implement this Statement in financial statements for periods beginning after December 15, 2005.
> - Plans in which the sole or largest employer is a phase 2 government—with total annual revenues of $10 million or more but less than $100 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2006.
> - Plans in which the sole or largest employer is a phase 3 government—with total annual revenues of less than $10 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2007.
>
> If comparative financial statements are presented, restatement of prior-period financial statements is required. Early implementation is encouraged.

14. Significant New Accounting Pronouncement (continued)

In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section - an amendment of NCGA Statement 1*. This Statement amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, that guide the preparation of the statistical section. The statistical section presents detailed information, typically in ten-year trends, that assists users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess the economic condition of a government. This statement is effective for Statistical sections prepared for periods beginning after June 15, 2005.

In July 2004 the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. This Statement improves the relevance and usefulness of financial reporting by (a)requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b)providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. This statement will be effective as follows:

> The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:
>
> - Governments that were phase 1 governments for the purpose of implementation of Statement 34—those with annual revenues of $100 million or more—are required to implement this Statement in financial statements for periods beginning after December 15, 2006.
>
> - Governments that were phase 2 governments for the purpose of implementation of Statement 34—those with total annual revenues of $10 million or more but less than $100 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2007.
>
> - Governments that were phase 3 governments for the purpose of implementation of Statement 34—those with total annual revenues of less than $10 million—are required to implement this Statement in financial statements for periods beginning after December 15, 2008.
>
> Earlier application of this Statement is encouraged. All component units should implement the requirements of this Statement no later than the same year as their primary government.

14. Significant New Accounting Pronouncement (continued)

In December 2004, the GASB issued Statement No. 46, *Net Assets Restricted by Legislation - an amendment of GASB Statement No. 34*. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. The Statement states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. Although the determination that a particular restriction is not legally enforceable may cause a government to review the enforceability of other restrictions, it should not necessarily lead a government to the same conclusion for all enabling legislation restrictions. This statement is effective for periods beginning after June 15, 2005. Earlier application is encouraged.

15. Subsequent Events

On July 29, 2005, the Legislative Assembly of Puerto Rico approved Law 36 which amended Law Act 139 of 1999, reinstating the funds to the University corresponding to the Slot Machines Revenue.

On September 26, 2005, the Medical Science Campus was granted a Public Health Grant of $15 million development of research infrastructure and capacity for the conduct, collaboration and promotion of scientifically meritorious research. The University will receive this during the next three years, for a total award of $15 million.

On November 19, 2005, the Board of Trustees of the University approved a Resolution (Certification No. 43 2005-2006) authorizing the execution and delivery of separate Master Agreements, refunding a portion of its bonds and also simultaneously issuing bonds (New Money) to defray the cost of certain necessary capital improvements at the University of Puerto Rico.

Other Financial Information

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Schedule of Changes in Sinking Fund Reserve

	2005			2004		
	Bond Service Account	Bond Reserve Account	Total	Bond Service Account	Bond Reserve Account	Total
Additions:						
Transfer from Reserve Account	$ 4,834,555	$ -	$ 4,834,555	$ 3,607,039	$ -	$ 3,607,039
Transfer from unrestricted current funds	33,039,508	1,677,432	34,716,940	39,508,764	4,084,757	43,593,520
Net increase in fair marker value of investments	47,519	41,939	89,458	1	160,694	160,694
Interest Earned on Investments	148,874	697,944	846,818	102,704	274,648	377,352
Total receipts	38,070,456	2,417,315	40,487,771	43,218,507	4,520,098	47,738,605
Deductions:						
Payments of bond interest	20,815,446	-	20,815,446	22,048,516	-	22,048,516
Payments of bond principal	17,255,000	-	17,255,000	21,170,000	-	21,170,000
Transfer to Reserve Account	-	4,834,555	4,834,555	-	3,607,039	3,607,039
Total disbursements	38,070,446	4,834,555	42,905,001	43,218,516	3,607,039	46,825,555
Net increase/(decrease) for the year	10	(2,417,240)	(2,417,230)	(9)	913,059	913,050
Balances at beginning of year	0	41,573,018	41,573,018	10	40,659,959	40,659,969
Balance at end of year	$ 10	$ 39,155,778	$ 39,155,788	$ 1	$ 41,573,018	$ 41,573,019

Report on Independent Auditors
on Compliance and Internal Control Over Financial Reporting
in Accordance with Government Auditing Standards

Board of Trustees
University of Puerto Rico

We have audited the financial statements of the University of Puerto Rico (the University) as of and for the year ended June 30, 2005, and have issued our report thereon dated October 31, 2005. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control and its operation that we consider to be a material weakness. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the University in a separate letter dated November 29, 2004.

Compliance

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that we have reported to management of the University in a separate letter dated October 31, 2005.

This report is intended for the information of the board of trustees, management and Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

October 31, 2005

Stamp No. 2093889
affixed to original
of this report.

APPENDIX – B

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FOUNDED 1866

December __, 2006

Board of Trustees
University of Puerto Rico
Rio Piedras, Puerto Rico

Ladies and Gentlemen:

We have examined Act No. 1 of the Legislature of Puerto Rico, approved January 20, 1966, reorganizing the University of Puerto Rico (the "University") and continuing the University as a public corporation of the Commonwealth of Puerto Rico, as amended by Act No. 16 of the Legislature of Puerto Rico, approved June 16, 1993, and Act No. 50 of the Legislature of Puerto Rico, approved June 18, 1958, as amended by Act No. 3 of the Legislature of Puerto Rico, approved January 20, 1966, authorizing the issuance of revenue bonds of the University (said Acts being herein collectively called the "Enabling Acts").

We have also examined certified copies of the proceedings of the Board of Trustees (the "Board") (formerly the Council on Higher Education), the governing board of the University, in authorizing the execution and delivery of the Agreement (hereinafter mentioned) and the issuance of the University System Revenue Bonds of the University hereinafter described, and other proofs submitted relative to the issuance of:

$259,645,000

UNIVERSITY OF PUERTO RICO
UNIVERSITY SYSTEM REVENUE BONDS, SERIES Q
Dated: Date of Delivery.

Maturing on June 1 of the years, bearing interest at the rates, subject to redemption and having such other details, all as set forth in a resolution of the Board authorizing the issuance of said bonds (the "Resolution").

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

From such examination we are of the opinion that:

1. The Enabling Acts are valid.

2. Said proceedings have been validly and legally taken.

3. Said University System Revenue Bonds, Series Q (the "Series Q Bonds") have been duly authorized and issued under the provisions of the Puerto Rican Federal Relations Act and the Constitution and laws of the Commonwealth of Puerto Rico, including the Enabling Acts, for the purpose of financing or refinancing part of the cost of the Capital Improvement Program (as defined in the Agreement), including the payment of notes heretofore issued by the University for such purpose.

As authorized by said proceedings, a trust agreement, dated as of June 1, 1971, as amended (herein called the "Agreement"), has been duly executed and delivered by and among the University, U.S. Bank Trust National Association, in the Borough of Manhattan, City and State of New York, successor Trustee, and Banco Popular de Puerto Rico, in San Juan, Puerto Rico, Co-Trustee, which is a valid and binding trust agreement for the security of the bonds in accordance with its terms and contains reasonable and sufficient covenants and provisions, in accordance with law, with respect to the construction of the University System (as defined in the Agreement), the custody and application of the proceeds of the bonds, the collection and disposition of revenues, the conservation and application of all funds, the safeguarding of moneys on hand or on deposit, and the rights and remedies of the Trustee, the Co-Trustee and of the holders of the bonds.

5. The Series Q Bonds are valid and binding general obligations of the University of Puerto Rico, payable from any moneys of the University available therefor and from the University System Bond and Interest Sinking Fund (herein called the "Sinking Fund"), a special fund created by the Agreement, which special fund is pledged to and charged with the payment of the principal of and the interest on all bonds issued under the provisions of the Agreement.

6. The Agreement provides for fixing and revising the tuition fees and student fees to be collected from all students of the University and the rentals and other charges for the services or facilities furnished or to be furnished by the University System so that the revenues received by the University therefrom and from net bookstore receipts, from interest on investment of certain funds of the University and from all other sources other than appropriations, contributions and amounts received under the debt service grant programs of the United States Government or any agency thereof (such revenues, together with amounts received under the debt service grant programs of the United States Government or any agency thereof, being herein collectively called the "Pledged Revenues") together with any other available funds, including funds appropriated by the Legislature of Puerto Rico, will be at least sufficient at all times to pay the principal of and the redemption premium, if any, and the interest on all bonds

issued under the provisions of the Agreement as the same shall become due and payable, after deducting any amounts received through the debt service grant programs of the Untied States Government or any agency thereof, and to provide reserves therefor.

7. The Agreement provides for the deposit to the credit of the Sinking Fund of an amount of the Pledged Revenues sufficient to provide for the payment of the principal of and the redemption premium, if any, and the interest on all bonds issued and outstanding under the provisions of the Agreement as the same shall become due and payable, and to provide a reserve for such purpose.

8. The Agreement provides for the issuance, from time to time, under the conditions, limitations and restrictions therein set forth, of additional series of bonds for the purpose of paying all or a part of the cost of improvements, renewals and replacements of, and extensions and additions to, the University System, additional buildings, structures or facilities of a capital nature on any land or campus of the University or to refund bonds of the University issued under the provisions of said Act No. 50, or other law of the Commonwealth of Puerto Rico.

9. The bonds issued under the provisions of the Agreement shall not constitute a debt or obligation of the Commonwealth of Puerto Rico or of any municipality or other political subdivision of Puerto Rico, the good faith and credit of the Commonwealth of Puerto Rico have not been pledged for the payment of the bonds, and neither the Commonwealth of Puerto Rico nor any municipality or other political subdivision of Puerto Rico shall be liable for the payment of the bonds or the redemption premium, if any, or the interest thereon.

10. Under the provisions of the Acts of Congress now in force and under existing regulations, rulings and judicial decisions, (i) subject to continuing compliance with the covenant referred to below and requirements of the Internal Revenue Code of 1986, as amended (the "Code"), and the Resolution regarding the use, expenditure and investment of Series Q Bond proceeds (and the proceeds of University System Revenue Refunding Bonds, Series P, being issued on the date hereof (the "Series P Bonds")) and the timely payment of certain investment earnings to the Treasury of the United States, if required, interest on the Series Q Bonds is not includable in gross income for federal income tax purposes; and (ii) the Series Q Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. No opinion is expressed as to the effect of any action taken or not taken after the date of this opinion without our approval (except for such action or omission to act as is provided for in the documents pertaining to the Series Q Bonds) or in reliance upon advice of counsel other than ourselves on the exclusion from gross income of the interest on the Series Q Bonds for federal income tax purposes.

Interest on the Series Q Bonds is not a specific item of tax preference for the purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Series Q Bonds is, however, includable in the computation of the alternative minimum tax on corporations imposed by the Code. The Code contains other provisions that could result in tax consequences, upon which we express no opinion, as a result of (a) ownership of the Series Q Bonds or (b) the inclusion in certain computations (including, without limitation, those related to the corporate alternative minimum tax) of interest that is excluded from gross income.

The University has covenanted to comply, to the extent permitted by the Constitution and law of the Commonwealth of Puerto Rico, with the requirements of the Code with respect to the Series Q Bonds and the Series P Bonds so that interest on the Series Q Bonds will remain exempt from federal income taxes to which it is not subject on the date of issuance of the Series Q Bonds. We are not aware of any provisions of the Constitution and laws of the Commonwealth of Puerto Rico which would prevent such compliance.

Respectfully submitted,

[to be signed, "Sidley Austin LLP"]

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FOUNDED 1866

December __, 2006

Board of Trustees
University of Puerto Rico
Rio Piedras, Puerto Rico

Ladies and Gentlemen:

We have examined Act No. 1 of the Legislature of Puerto Rico, approved January 20, 1966, reorganizing the University of Puerto Rico (the "University") and continuing the University as a public corporation of the Commonwealth of Puerto Rico, as amended by Act No. 16 of the Legislature of Puerto Rico, approved June 16, 1993, and Act No. 50 of the Legislature of Puerto Rico, approved June 18, 1958, as amended by Act No. 3 of the Legislature of Puerto Rico, approved January 20, 1966, authorizing the issuance of revenue bonds of the University (said Acts being herein collectively called the "Enabling Acts").

We have also examined certified copies of the proceedings of the Board of Trustees (the "Board") (formerly the Council on Higher Education), the governing board of the University, in authorizing the execution and delivery of the Agreement (hereinafter mentioned) and the issuance of the bonds of the University hereinafter described, and other proofs submitted relative to the issuance of:

$286,505,000

UNIVERSITY OF PUERTO RICO
UNIVERSITY SYSTEM REVENUE REFUNDING BONDS, SERIES P
Dated: Date of Delivery.

Maturing on June 1 of the years, bearing interest at the rates, subject to redemption and having such other details, all as set forth in a resolution of the Board authorizing the issuance of said bonds (the "Resolution").

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

From such examination we are of the opinion that:

1. The Enabling Acts are valid.

2. Said proceedings have been validly and legally taken.

3. Said University System Revenue Refunding Bonds, Series P (the "Series P Bonds") have been duly authorized and issued under the provisions of the Puerto Rican Federal Relations Act and the Constitution and laws of the Commonwealth of Puerto Rico, including the Enabling Acts, for the purpose of refunding certain outstanding bonds of the University issued under the Agreement and that were issued for the purpose of paying part of the cost of the Capital Improvement Program (as defined in the Agreement), including the payment of notes heretofore issued by the University for such purpose.

As authorized by said proceedings, a trust agreement, dated as of June 1, 1971, as amended (herein called the "Agreement"), has been duly executed and delivered by and among the University, U.S. Bank Trust National Association, in the Borough of Manhattan, City and State of New York, successor Trustee, and Banco Popular de Puerto Rico, in San Juan, Puerto Rico, Co-Trustee, which is a valid and binding trust agreement for the security of the bonds in accordance with its terms and contains reasonable and sufficient covenants and provisions, in accordance with law, with respect to the construction of the University System (as defined in the Agreement), the custody and application of the proceeds of the bonds, the collection and disposition of revenues, the conservation and application of all funds, the safeguarding of moneys on hand or on deposit, and the rights and remedies of the Trustee, the Co-Trustee and of the holders of the bonds.

5. The Series P Bonds are valid and binding general obligations of the University of Puerto Rico, payable from any moneys of the University available therefor and from the University System Bond and Interest Sinking Fund (herein called the "Sinking Fund"), a special fund created by the Agreement, which special fund is pledged to and charged with the payment of the principal of and the interest on all bonds issued under the provisions of the Agreement.

6. The Agreement provides for fixing and revising the tuition fees and student fees to be collected from all students of the University and the rentals and other charges for the services or facilities furnished or to be furnished by the University System so that the revenues received by the University therefrom and from net bookstore receipts, from interest on investment of certain funds of the University and from all other sources other than appropriations, contributions and amounts received under the debt service grant programs of the United States Government or any agency thereof (such revenues, together with amounts received under the debt service grant programs of the United States Government or any agency thereof, being herein collectively called the "Pledged Revenues") together with any other available funds,

including funds appropriated by the Legislature of Puerto Rico, will be at least sufficient at all times to pay the principal of and the redemption premium, if any, and the interest on all bonds issued under the provisions of the Agreement as the same shall become due and payable, after deducting any amounts received through the debt service grant programs of the Untied States Government or any agency thereof, and to provide reserves therefor.

7. The Agreement provides for the deposit to the credit of the Sinking Fund of an amount of the Pledged Revenues sufficient to provide for the payment of the principal of and the redemption premium, if any, and the interest on all bonds issued and outstanding under the provisions of the Agreement as the same shall become due and payable, and to provide a reserve for such purpose.

8. The Agreement provides for the issuance, from time to time, under the conditions, limitations and restrictions therein set forth, of additional series of bonds for the purpose of paying all or a part of the cost of improvements, renewals and replacements of, and extensions and additions to, the University System, additional buildings, structures or facilities of a capital nature on any land or campus of the University or to refund bonds of the University issued under the provisions of said Act No. 50, or other law of the Commonwealth of Puerto Rico.

9. The bonds issued under the provisions of the Agreement shall not constitute a debt or obligation of the Commonwealth of Puerto Rico or of any municipality or other political subdivision of Puerto Rico, the good faith and credit of the Commonwealth of Puerto Rico have not been pledged for the payment of the bonds, and neither the Commonwealth of Puerto Rico nor any municipality or other political subdivision of Puerto Rico shall be liable for the payment of the bonds or the redemption premium, if any, or the interest thereon.

10. Under the provisions of the Acts of Congress now in force and under existing regulations, rulings and judicial decisions, (i) subject to continuing compliance with the covenant referred to below and requirements of the Internal Revenue Code of 1986, as amended (the "Code"), and the Resolution regarding the use, expenditure and investment of Series P Bond proceeds (and the proceeds of University System Revenue Bonds, Series Q, being issued on the date hereof (the "Series Q Bonds")) and the timely payment of certain investment earnings to the Treasury of the United States, if required, interest on the Series P Bonds is not includable in gross income for federal income tax purposes; and (ii) the Series P Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. No opinion is expressed as to the effect of any action taken or not taken after the date of this opinion without our approval (except for such action or omission to act as is provided for in the documents pertaining to the Series P Bonds) or in reliance upon advice of counsel other than ourselves on the exclusion from gross income of the interest on the Series P Bonds for federal income tax purposes.

Interest on the Series P Bonds is not a specific item of tax preference for the purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Series P Bonds is, however, includable in the computation of the alternative minimum tax on corporations imposed by the Code. The Code contains other provisions that could result in tax consequences, upon which we express no opinion, as a result of (a) ownership of the Series P Bonds or (b) the inclusion in certain computations (including, without limitation, those related to the corporate alternative minimum tax) of interest that is excluded from gross income.

The University has covenanted to comply, to the extent permitted by the Constitution and law of the Commonwealth of Puerto Rico, with the requirements of the Code with respect to the Series P Bonds and Series Q Bonds so that interest on the Series P Bonds will remain exempt from federal income taxes to which it is not subject on the date of issuance of the Series P Bonds. We are not aware of any provisions of the Constitution and laws of the Commonwealth of Puerto Rico which would prevent such compliance.

Respectfully submitted,

[to be signed, "Sidley Austin LLP"]

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