

**Puerto Rico Industrial, Tourist,
Educational, Medical, and
Environmental Control
Facilities Financing Authority**
(A Component Unit of the Commonwealth of Puerto Rico)

**Basic Financial Statements and Required Supplementary
Information as of and for the Year Ended
June 30, 2010, and Independent Auditors' Report**

PUERTO RICO INDUSTRIAL, TOURIST, EDUCATIONAL, MEDICAL, AND ENVIRONMENTAL CONTROL FACILITIES FINANCING AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Puerto Rico Industrial, Tourist, Educational, Medical, and
Environmental Control Facilities Financing Authority
San Juan, Puerto Rico

We have audited the accompanying statement of net assets (deficit) of Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (the "Authority"), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2010, and the related statements of revenues, expenses, and changes in net assets (deficit) and of cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in 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 Authority'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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority as of June 30, 2010, and its changes in net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Authority's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

January 28, 2011

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PUERTO RICO INDUSTRIAL, TOURIST, EDUCATIONAL, MEDICAL, AND ENVIRONMENTAL CONTROL FACILITIES FINANCING AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2010

As management of the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (the "Authority"), we offer readers of the Authority's financial statements this narrative overview and analysis of the Authority's financial performance during the fiscal year ended June 30, 2010. Please read it in conjunction with the Authority's basic financial statements, which follow this section.

(1) Financial highlights:

- The Authority's total net assets decreased \$11.1 million or 124% during the fiscal year 2010.
- During fiscal year 2010 conduit debt was issued for the San Patricio Plaza Project for \$21.8 million. This bond issue generated \$218,000 in placement fees.
- The Authority's operating losses for the years ended June 30, 2010 and 2009 were \$44,000 and \$51,000, respectively.
- In August 2009, the Authority entered into a transaction with the Government Development Bank for Puerto Rico (the "Bank"), Puerto Rico Electric Power Authority ("PREPA"), and Puerto Rico Aqueduct and Sewer Authority ("PRASA") for the acquisition of certain assets originally intended to be used by PREPA for its Southern Gas Pipeline Project (the "Project"). The Authority borrowed \$59.1 million from the Bank, made a \$26.3 million subordinated loan to PREPA to finance a portion of PREPA's acquisition of these assets from the original contractor for the Project, acquired most of these assets from PREPA for \$32.8 million, and agreed to sell most of these assets to PRASA, within the next 24 months for \$23.5 million in cash plus the assumption of the Authority's subordinated loan to PREPA. The Authority recognized a loss of \$9.3 million on certain of these assets. The Authority will make its best effort to recover a portion or all of this loss from PREPA and has engaged in negotiations in this regard.

(2) Overview of the financial statements:

The financial statements include the management's discussion and analysis narrative, the independent auditors' report, and the basic financial statements of the Authority. The notes to the basic financial statements explain in more detail some of the information in the basic financial statements.

(3) Required financial statements:

The financial statements of the Authority report information of the Authority using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about its activities. The statement of net assets (deficit) includes all of the Authority's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the net assets of the Authority and assessing its liquidity and financial flexibility.

PUERTO RICO INDUSTRIAL, TOURIST, EDUCATIONAL, MEDICAL, AND ENVIRONMENTAL CONTROL FACILITIES FINANCING AUTHORITY
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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2010

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net assets (deficit). This statement measures the success of the Authority's operations over the past year and can be used to determine whether the Authority has successfully recovered its costs through its user fees and other charges.

The final required financial statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and capital and noncapital financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

(4) Financial analysis:

The statement of net assets (deficit) and the statement of revenues, expenses, and changes in net assets (deficit) report information about the Authority's activities in a way that will help determine whether the Authority as a whole is better or worse financially as a result of this year's activities. These two statements report the net assets (deficit) of the Authority and the changes in them. One can think of the Authority's net assets—the difference between assets and liabilities—as one way to measure financial health or financial position. Over time, increases or decreases in the Authority's net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other nonfinancial factors such as changes in economic conditions, population growth, and new or changed government legislation.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2010

(5) Unrestricted net assets (deficit) and changes in net assets (deficit):

Condensed financial information on assets, liabilities and unrestricted net assets are presented below (in thousands):

	<u>June 30</u>		<u>Change</u>	
	<u>2010</u>	<u>2009</u>	<u>Amount</u>	<u>Percent</u>
Assets:				
Current assets	\$ 9,290	\$ 9,060	\$ 230	3 %
Noncurrent assets	<u>49,742</u>	<u>-</u>	<u>49,742</u>	- %
Total assets	<u>59,032</u>	<u>9,060</u>	<u>49,972</u>	552 %
Liabilities:				
Current liabilities	2,098	92	2,006	2,180%
Noncurrent liabilities	<u>59,100</u>	<u>-</u>	<u>59,100</u>	- %
Total liabilities	<u>61,198</u>	<u>92</u>	<u>61,106</u>	66,420 %
Unrestricted net assets (deficit)	<u>\$ (2,166)</u>	<u>\$ 8,968</u>	<u>\$ (11,134)</u>	(124)%

As can be seen from the table above, unrestricted net assets decreased \$11.1 million in 2010. The decrease in net assets (deficit) was mainly due to the transaction with other component units of the Commonwealth of Puerto Rico related to the Southern Gas Pipeline Project described in the financial highlights.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2010

Condensed financial information on revenues, expenses, and changes in net assets (deficit) are presented below (in thousands):

	June 30,		Change	
	2010	2009	Amount	Percent
Operating revenues —				
Placement fees	\$ 218	\$ -	\$ 218	- %
Operating expenses:				
Service fees	109		109	- %
General and administrative	153	51	102	200%
Total operating expenses	262	51	211	6,547 %
Operating loss	(44)	(51)	7	3,398 %
Nonoperating revenues (expenses):				
Interest income on deposits	9	85	(76)	(89%)
Interest income on loan	1,388		1,388	- %
Interest expense on loan	(3,128)		(3,128)	- %
Loss on other assets	(9,359)		(9,359)	- %
Other income		206	(206)	(100%)
Total nonoperating expenses	(11,090)	291	(11,381)	(3,911 %)
Change in unrestricted net assets (deficit)	(11,134)	240	(11,374)	(4,739 %)
Unrestricted net assets — beginning of year	8,968	8,728	240	3%
Unrestricted net assets (deficit) — end of year	\$ (2,166)	\$ 8,968	\$ (11,134)	(124%)

While comparative statements of net assets (deficit) show the change in financial position of the Authority, the statements of revenues, expenses, and changes in net assets (deficit) provide answers as to the nature and source of these changes.

The Authority's nonoperating expenses increased by \$11.4 million when compared with fiscal year 2009 mainly due to the expenses and losses incurred in connection the transaction with other component units of the Commonwealth of Puerto Rico related to the Southern Gas Pipeline Project described in the financial highlights.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2010

(6) Debt administration – conduit debt:

The Authority's main operations consist of issuing revenue bonds that are considered conduit debt and, therefore, neither these bonds nor the related loans granted by the Authority are presented in the accompanying basic financial statements. Revenue is earned from the collection of a placement fee which generally represents 1% of the face value of the bonds issued, except for bonds issued to finance educational, medical, or environmental control facilities or other projects otherwise eligible to be financed in the U.S. tax-exempt bond market, for which the placement fee charged is one half of 1%. The revenue bonds are special and limited obligations of the Authority and, except to the extent payable from bond proceeds and investments thereof, will be payable solely from and secured by a pledge and assignment of the amounts receivable under the loan agreements between the Authority and the borrowers.

Furthermore, payment of the principal and interest on the revenue bonds is unconditionally guaranteed by the borrowers, their parent companies, or letters of credit generally issued by major U.S. banks or U.S. branches of international banks. The revenue bonds do not constitute a debt or a pledge of the good faith and credit of the Authority or the Commonwealth of Puerto Rico or any political subdivision thereof.

As of June 30, 2010, the Authority has \$5,997 million, in revenue bonds outstanding. See note 7 to the basic financial statements for the composition of the types of revenue bonds outstanding.

(7) Contacting the Authority's financial management:

This financial report is designed to provide all interested with a general overview of the Authority's finances and to enhance the Authority's accountability for the resources it manages. If you have questions about this report or need additional financial information, contact the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority, P.O. Box 42001, San Juan, Puerto Rico, 00940-2001.

PUERTO RICO INDUSTRIAL, TOURIST, EDUCATIONAL, MEDICAL, AND ENVIRONMENTAL CONTROL FACILITIES FINANCING AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF NET ASSETS (DEFICIT)
AS OF JUNE 30, 2010

ASSETS:

Current assets:

Cash	\$ 9,022,185
Accrued interest receivable on deposits	743
Accrued interest receivable on loan	<u>267,092</u>
Total current assets	<u>9,290,020</u>

Noncurrent assets:

Loan receivable	26,271,418
Other assets	<u>23,470,706</u>
Total noncurrent assets	<u>49,742,124</u>

Total assets	<u>59,032,144</u>
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LIABILITIES:

Current liabilities:

Accrued interest payable	2,007,002
Accrued liabilities and other payables	<u>90,748</u>
Total current liabilities	2,097,750

Noncurrent liabilities—

Notes payable to bank	<u>59,099,896</u>
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Total liabilities	<u>61,197,646</u>
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UNRESTRICTED NET DEFICIT	<u>\$ (2,165,502)</u>
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See notes to basic financial statements.

PUERTO RICO INDUSTRIAL, TOURIST, EDUCATIONAL, MEDICAL, AND ENVIRONMENTAL CONTROL FACILITIES FINANCING AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (DEFICIT)
FOR THE YEAR ENDED JUNE 30, 2010

OPERATING REVENUES —	
Placement fees	\$ <u>217,750</u>
OPERATING EXPENSES:	
Service fees	108,875
General and administrative	<u>153,343</u>
Total operating expenses	<u>262,218</u>
OPERATING LOSS	(44,468)
NONOPERATING REVENUES (EXPENSES):	
Interest income on deposits	9,187
Interest income on loan	1,388,273
Interest expense on loan	(3,128,182)
Loss on other assets	<u>(9,358,323)</u>
CHANGE IN UNRESTRICTED NET ASSETS (DEFICIT)	<u>(11,133,513)</u>
UNRESTRICTED NET ASSETS—Beginning of year	<u>8,968,011</u>
UNRESTRICTED NET DEFICIT—End of year	<u>\$ (2,165,502)</u>

See notes to basic financial statements.

**PUERTO RICO INDUSTRIAL, TOURIST, EDUCATIONAL, MEDICAL, AND
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STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2010

CASH FLOWS FROM OPERATING ACTIVITIES:	
Placement fees collected	\$ 217,750
Payments to employees and service providers	<u>(263,759)</u>
Net cash used in operating activities	<u>(46,009)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Proceeds from loan payable	59,099,896
Interest paid	(1,121,180)
Purchases of other assets	<u>(32,828,478)</u>
Net cash provided by noncapital financing activities	<u>25,150,238</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Origination of loan	(26,271,418)
Interest received	<u>1,130,380</u>
Net cash used in investing activities	<u>(25,141,038)</u>
NET DECREASE IN CASH	(36,809)
CASH — Beginning of year	<u>9,058,994</u>
CASH — End of year	<u>\$ 9,022,185</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:	
Operating loss	\$ (44,468)
Adjustments to reconcile operating loss to net cash used in operating activities –	
Changes in assets and liabilities:	
Increase in other assets	(329)
Decrease in accrued liabilities and other payables	<u>(1,212)</u>
Total adjustments	<u>(1,541)</u>
Net cash used in operating activities	<u>\$ (46,009)</u>

See notes to basic financial statements.

PUERTO RICO INDUSTRIAL, TOURIST, EDUCATIONAL, MEDICAL, AND ENVIRONMENTAL CONTROL FACILITIES FINANCING AUTHORITY
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NOTES TO BASIC FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2010

1. REPORTING ENTITY

Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (the “Authority”) is a component unit of the Commonwealth of Puerto Rico (the “Commonwealth”) and an affiliate of the Government Development Bank for Puerto Rico (the “Bank”), created by Act No. 121 (the “Act”) of the Legislature of the Commonwealth on June 27, 1977, as amended.

The Authority was created to issue revenue bonds and to lend the proceeds thereof to finance the acquisition, construction, and equipping of industrial, tourist, educational, medical, and environmental control facilities. The Authority charges a placement fee on the face value of the bonds issued. The Authority is exempt from taxation in Puerto Rico.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The accounting and reporting policies of the Authority conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Authority follows Governmental Accounting Standards Board (“GASB”) under the hierarchy established by Statement No. 55, *The Hierarchy of Generally Accepted Principles for State and Local Governments*, in the preparation of its financial statements. The Authority has elected to apply all Financial Accounting Standards Board’s pronouncements issued after November 30, 1989, in accounting and reporting for its enterprise funds and business type activities to the extent they did not conflict with GASB pronouncements.

Following is a description of the Authority’s significant accounting policies:

Measurement Focus and Basis of Accounting — The Authority’s financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred, regardless of the timing of related cash flows. The Authority’s placement fee income is recognized upon the issuance of the bonds.

Operating Revenues and Expenses — Operating revenues and expenses are distinguished from nonoperating items. The only operating revenue of the Authority is the placement fees charged to borrowers. Operating expenses include administrative expenses and other costs associated with the issuance of bonds, such as service fees charged to the Authority by the Bank, another component unit of the Commonwealth (see Note 4).

Revenue Bonds and Related Loans — Revenue bonds issued by the Authority are considered conduit debt (refer to note 7) and, therefore, neither these bonds nor the related loans granted by the Authority are presented in the accompanying basic financial statements.

The GASB has issued the following accounting pronouncements that have effective date after June 30, 2010:

- GASB Statement No. 54 — *Fund Balance Reporting and Governmental Fund Type Definitions*, which is effective for periods beginning after June 15, 2010.
- GASB Statement No. 57 — *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which is effective for periods beginning after June 15, 2011.
- GASB Statement No. 59 — *Financial Instruments Omnibus*, which is effective for periods beginning after June 15, 2010.

The impact of these pronouncements in the Authority's basic financial statements has not yet been determined.

3. CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposit may not be returned to it. The Authority does not have a policy for custodial credit risk. As of June 30, 2010, all of the Authority's bank balance, aggregating approximately \$9,023,000, was exposed to custodial credit risk since such deposits, all of which are maintained at the Bank, are uninsured and uncollateralized.

4. TRANSACTIONS WITH GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO:

The Bank provides certain services to the Authority and charges a fee for these services equal to half of the placement fee charged by the Authority to borrower. Service fees for the year ended June 30, 2010 amounted to approximately \$109 thousand.

5. TRANSACTION WITH OTHER COMPONENTS UNITS OF THE COMMONWEALTH

On August 17, 2009, the Authority entered into an agreement with the Bank, Puerto Rico Electric Power Authority ("PREPA"), and Puerto Rico Aqueduct and Sewer Authority ("PRASA") for the acquisition of certain assets originally intended to be used by PREPA for its Southern Gas Pipeline Project (the "Project"). The Project was being built by Skanska Energy Services LLC and Skanska Puerto Rico Pipeline LLC ("Skanska") under an agreement with PREPA. The parties agreed that it was in the best interest of the Government of Puerto Rico that the Skanska agreement be terminated and that the Project assets be utilized for the construction of an aqueduct by PRASA. PREPA paid \$59 million to Skanska in exchange for the transfer of the Project assets to PREPA and the termination of the agreement. The Authority acquired most of these assets from PREPA for \$32.8 million and made a \$26.3 million subordinated loan to PREPA to finance PREPA's acquisition of these assets from Skanska. The Authority, in turn, borrowed \$59.1 million from the Bank to finance this purchase and the related loan. Both the loan from the Bank to the Authority and the loan from the Authority to PREPA provide for an interest rate of 6% and are due on August 17, 2011. The Authority also entered into an asset purchase agreement with PRASA that provides that not later August 17, 2011, PRASA will purchase most of the Project's assets from the Authority, for \$23.5 million in cash and the assumption of PREPA's subordinated note. The Authority has recorded a loss on this transaction of \$9.3 in the accompanying statement of revenues, expenses, and changes in net assets.

As of June 30, 2010, PREPA's subordinated note balance is \$26.3 million, and the balance in the Authority's loans with the Bank is \$59.1 million.

6. PLACEMENT FEES

The Authority generally charges a placement fee of 1% of the face value of bond issued or as deemed appropriate for the specific issue, except for bonds issued to finance educational, medical, or environmental control facilities or other projects otherwise eligible to be financed in the U.S. tax-exempt bond market, for which the placement fee charged is one half of 1%. During the fiscal year ended June 30, 2010, the placement fees charged were approximately \$218,000 for the bond issue of San Patricio Plaza Project 2009, Series A.

7. REVENUE BONDS

The revenue bonds are special and limited obligations of the Authority and, except to the extent payable from bond proceeds and investments thereof, will be payable solely from and secured by a pledge and assignment of the amounts payable under the loan agreements between the Authority and the borrowers. Furthermore, payment of principal and interest on the revenue bonds is unconditionally guaranteed by the borrowers, their parent companies, or letters of credit generally issued by major U.S. banks or U.S. branches of international banks.

The revenue bonds are considered conduit debt and do not constitute a debt or a pledge of the good faith and credit of the Authority or the Commonwealth or any political subdivision thereof (conduit debt, see Note 2).

In connection with the issuance of revenue bonds, the Authority enters into trust agreements, whereby the Authority assigns and pledges to the trustees, for the benefit of the holders of the revenue bonds, (1) all amounts receivable by the Authority in repayment of the amounts due under the loan agreements; (2) any rights, title, and interest of the Authority in the proceeds derived from the issuance of the revenue bonds and of any securities in which moneys in any fund or account created by the trust agreements or loan agreements are invested and the proceeds derived therefrom; and (3) the Authority's rights, title, and interest in and to the loan agreements, subject to the Authority's retention of certain rights, including the right to collect moneys payable to the Authority, which are not received with respect to repayment of the loans.

Since inception and up to June 30, 2010, the Authority has issued revenue bonds aggregating to \$5,997 million, \$1,328 of which was outstanding as of June 30, 2010. Of the revenue bonds outstanding at June 30, 2010, \$755 million represent industrial and commercial revenue bonds; \$106 million, tourism related revenue bonds; \$141 million, hospital revenue bonds; and \$326 million, educational revenue bonds. Pursuant to the loan agreements covering the issuance of these bonds, corporations and partnerships operating in Puerto Rico borrowed the proceeds from the bond issuances by the Authority.

8. SUBSEQUENT EVENTS

Subsequent events were evaluated through January 28, 2011, the date the financial statements were available to be issued, to determine if any such events should either be recognized or disclosed in the 2010 financial statements.

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