

# OFFICIAL STATEMENT

**\$7,497,854.10**

## **Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority Tourism Revenue Bonds, 2004 Series A (COCO BEACH GOLF & COUNTRY CLUB PROJECT)**

The bonds offered hereby (the “2004 Bonds”) have the following characteristics:

- The Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (the “Authority”) will issue the 2004 Bonds and will lend the proceeds to Coco Beach Golf & Country Club, S.E. (the “Borrower”).
- The Authority is required to pay the 2004 Bonds solely out of loan repayments by Borrower under the Loan Agreement (as defined herein). The 2004 Bonds do not constitute a debt of the Government of Puerto Rico or any of its political subdivisions, other than the Authority.
- Puerto Rico Tourism Development Fund (“TDF”) will amend and restate its existing irrevocable transferable stand by letter of credit securing the payment of principal and interest when due on the \$18,000,000 bonds issued in September 28, 2000 by the Authority relating to the Coco Beach Golf & Country Club Project (the “Project”) (the “2000 Bonds”, and together with the 2004 Bonds, the “Bonds”) to also secure the payment of principal and interest on the 2004 Bonds when due (as so amended, the “TDF Letter of Credit”). The TDF Letter of Credit is for an original term of 15 years expiring on December 20, 2015 and will be automatically extended for three additional periods of five years each followed by an additional period of four years.
- The Borrower will use the 2004 Bonds’ proceeds to finance, in part, the additional costs necessary for the completion of the Project, including deposits to the debt service reserve fund and the payment of certain costs of issuance.
- The Bonds are secured also by a mortgage on the real property on which the Project is being developed which is owned by the Borrower. Such security will be shared pro rata by the holders of the 2000 Bonds and the 2004 Bonds.
- The 2004 Bonds will be issued as fully registered bonds without coupons and will be initially registered only in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”) which will act as securities depository for the 2004 Bonds. The 2004 Bonds will be available in the initial principal amount denomination of \$5,000, and integral multiples thereof. Interest on the 2004 Bonds will accrue from the date of issuance until December 20, 2034 at an annual fixed rate of 6.00%. Interest on the 2004 Bonds initially will not be paid and will be added to the principal of such Bonds semiannually on each December 20 and June 20 until June 20, 2008 (the “Conversion Date”; the period of time during which interest will not be paid and will be added to the principal of the 2004 Bonds is referred to as the “Accretion Period”). Upon termination of the Accretion Period, interest on the accreted principal amount outstanding of the 2004 Bonds will be paid semiannually on the twentieth day of each June and December, or if such day is not a Business Day, on the next succeeding Business Day, commencing on December 20, 2008 (each such date, a “Payment Date”). On each Payment Date on which interest is paid, interest will be calculated on the basis of the principal amount outstanding after giving effect to the distributions of principal made on the prior Payment Date. No payments of accreted principal will be made on the 2004 Bonds prior to the Conversion Date. On each Payment Date after the Conversion Date, payments of principal will be made in the amounts set forth on Appendix C-2.
- The 2004 Bonds are subject to mandatory and optional redemption as described in this official statement.
- All terms not otherwise defined in this official statement shall have the respective meanings ascribed to them in the documents being summarized.
- For further information regarding the Borrower, and information relating to the Project, see Appendix A and Appendix B, respectively. The audited financial statements of TDF for the year ended June 30, 2003 are contained in Appendix D.

Interest on the 2004 Bonds will be exempt from Puerto Rico taxes and, under certain circumstances, United States taxes to residents of Puerto Rico. See “Tax Matters” beginning on page 30 of this official statement.

The Borrower and the Authority do not intend to apply for listing of the 2004 Bonds on a securities exchange. There will likely be no secondary public market for the 2004 Bonds.

**Investing in the 2004 Bonds involves risks. See “Bondholders’ Risk” beginning on page 1 of this official statement.**

**Prospective investors may only rely on the information contained in this official statement. None of the Authority, the Borrower or TDF has authorized anyone to provide prospective investors with information different from that contained in this official statement. 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 2004 Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information contained in this official statement is correct only as of the date of this official statement, regardless of the time of delivery of this official statement or the sale of these securities.**

August 12, 2004

<u>Maturity Date</u> <u>December 20</u>	<u>Initial</u> <u>Principal Amount</u>	<u>Appreciated Value as of</u> <u>June 20, 2008</u> <u>and Amount Due at Maturity</u>	<u>Price<sup>1</sup></u>
2034	\$7,497,854.10	\$9,405,000.00	79.722%

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(1) As a percentage of amount due at maturity.

## SUMMARY

*This summary highlights information contained elsewhere in this official statement. You should read the entire official statement and the “Bondholder’s Risks” section beginning on page 1.*

### The Borrower

The Borrower was organized on December 30, 1999 for the purpose of building, developing and owning the Coco Beach Golf & Country Club, which is intended to consist of two 18-hole championship golf courses, a clubhouse and related facilities.

As of the date of the issuance of the 2004 Bonds, the Borrower will have three partners, including a managing partner. The managing partner of the Borrower is Betterroads Asphalt Corporation (“Betterroads”), a Puerto Rico corporation, which has an 83% equity interest in the Borrower. The two other partners are PFP Coco Beach LP, a Delaware limited partnership that is an affiliate of Willowbend Development LLC, a Massachusetts limited liability company (“Willowbend”), which has a 7% equity interest in the Borrower, and Mr. Arturo Diaz, Jr., who has a 10% equity interest in the Borrower.

### The Project

The Project is intended to consist of two 18-hole championship golf courses, a clubhouse and related facilities. The Project will provide four different playing experiences. It will consist of four 9-hole half courses with different settings: mountains, oceansides, wetlands, and lakeside settings. The Project will be located on approximately 520 *cuerdas* of land in the Municipality of Río Grande on the northeast coast of Puerto Rico, approximately 21 miles east of the Luis Muñoz Marín International Airport, which are intended to be developed as a resort community (the “Resort”). The Project is being developed next to the Paradisus Puerto Rico Hotel, which is a 486-room luxury beach hotel and resort (the “Hotel”) that opened to the public in March 2004. The Hotel is the only European-chain hotel in Puerto Rico. The Borrower has entered into a use and access agreement (the “Use and Access Agreement”) with the Hotel owner, Desarrolladora del Norte, S. en C., S.E. (“Desarrolladora del Norte”), a Puerto Rico mercantile limited partnership, pursuant to which Hotel guests have the right to access and use the Project’s facilities and common areas subject to rules as are deemed advisable from time to time by the Borrower.

Within the planned resort community, there are two additional parcels intended to be developed as hotels and luxury residential housing units.

### Facilities and Construction of the Project

The Project has been developed in two phases. The first phase entailed the construction of the first 18-hole championship golf course, a clubhouse for the two golf courses and the installation of the land and irrigation system for the second golf course. The second phase consists of the construction of the second 18-hole golf course. All 36 holes of championship golf have been designed by PGA Tour Professional Tom Kite in collaboration with Bruce Besse of Willowbend Golf & Land Design.

The first 18-hole golf course comprises two 9-hole half courses named the Lakes Course and Ocean Course, having wide fairways, big greens and lakes. The construction of the first 18-hole golf course was completed in March 2004.

The second 18-hole golf course will comprise two 9-hole half courses to be known as Mountain Course and Wetland Course featuring vegetation, wild life and elevation changes. In addition, these two courses will have some holes located next to the wetlands of the Espíritu Santo River and will offer panoramic views of the Atlantic Ocean, Comezón Bay and *Punta Miquillos*. As of the date hereof, the construction of the second 18-hole golf course is 80% completed.

The Project will include a full service, first-class 46,000 square feet clubhouse considered the largest clubhouse in the Caribbean. The clubhouse is located on the eastern part of the peninsula and is elevated to take advantage of scenic ocean views. The clubhouse is 85% completed and will be furnished in a traditional Spanish pallet, featuring Puerto Rican artwork and decoration. Additional facilities will include a full service golf pro shop, indoor cart storage, golf bag storage area and administrative offices. Both the men's and women's locker rooms will feature Jacuzzi hot tubs, steam rooms, full showers and sanitary facilities along with an assortment of full and half size lockers.

From the date of issuance of the 2004 Bonds, the Project will take approximately 5 months to complete, and until such time the Borrower will only operate the Lakes and Ocean Courses. Such courses have been in use since March 2004.

The Borrower retained PFP Golf Construction L.P., S.E. (the "Construction Manager"), a subsidiary of Willowbend, to assist it in selecting and supervising the independent contractors for the different components of the Project. The Borrower has also engaged an affiliate of Willowbend, Willowbend Golf Management Coco Beach L.P., S.E. (as successor of PFP Golf Management L.P., S. E.) to operate the Project pursuant to a club management agreement (the "Management Agreement").

**The Offering**

Issuer ..... The Authority, a Puerto Rico government instrumentality.

2004 Bonds are limited obligations of the Authority ..... The Authority is required to pay the 2004 Bonds solely out of payments of principal and interest made by the Borrower to the Authority under the loan agreement, as supplemented by that certain supplemental loan agreement to be dated the date of issuance of the 2004 Bonds (as amended, the "Loan Agreement"). The 2004 Bonds do not constitute an indebtedness of the Government of Puerto Rico or of any of its political subdivisions, other than the Authority.

Use of proceeds ..... The Authority will lend the 2004 Bond proceeds to the Borrower. The Borrower will use the proceeds, together with other funds, to finance the completion of the construction of the Project, make required deposits into the debt service reserve fund and pay certain costs of issuance.

Letter of credit issuer ..... TDF will amend and restate its existing irrevocable transferable stand-by letter of credit securing the payment of principal and interest on the 2000 Bonds when due to also secure the payment of principal and interest on the 2004 Bonds when due.

Security for the 2004 Bonds ..... The 2004 Bonds will also be secured by (i) a first mortgage on the Project real property; and (ii) a first priority security interest on certain personal property of the Borrower, including various agreements and accounts. Such security will be shared pro rata by the holders of the 2004 Bonds and the holders of the 2000 Bonds.

Interest on the 2004 Bonds ..... The 2004 Bonds will be issued as fully registered bonds without coupons and will be initially registered only in the name of Cede & Co., as nominee of DTC which will act as securities depository for the 2004 Bonds. The 2004 Bonds will be available in the initial principal amount denomination of \$5,000, and integral multiples thereof. Interest on the 2004 Bonds will accrue from the date of issuance until December 20, 2034 at an annual fixed rate of 6.00%. Interest on the 2004 Bonds initially will not be paid and will be added to the principal of such Bonds semiannually on each December 20 and June 20 until the Conversion Date. Upon termination of the Accretion Period, interest on the accreted principal amount outstanding of the 2004 Bonds will be paid semiannually on each Payment Date. On each Payment Date on which interest is paid, interest will be calculated on the basis of the accreted principal amount outstanding after giving effect to the distributions of principal made on the prior Payment Date. No payments of principal will be made on the 2004 Bonds prior to the Conversion Date. On each Payment Date after the Conversion Date, payments of principal will be made in the amounts set forth on Appendix C-2. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months.

Mandatory redemption  
of Bonds .....

A portion of the 2004 Bonds may be redeemed from unused bond proceeds, if any.

All or a portion of the Bonds may be redeemed if all or part of the Project is expropriated or damaged.

The TDF letter of credit is subject to automatic extension until the maturity of the 2004 Bonds, however, in the event that the Borrower replaces the TDF letter of credit with a letter of credit from a bank, other financial institution, or governmental instrumentality, all of the Bonds will be redeemed if the Borrower fails to extend, renew or replace such successor letter of credit upon its expiration.

A portion of the 2004 Bonds will be redeemed on each Payment Date occurring after the Conversion Date in the amounts set forth in Appendix C-2.

Optional redemption  
of bonds .....

The Borrower has the right to redeem all or a portion of the 2004 Bonds on and after June 20, 2008, at the following prices, expressed as a percentage of the outstanding principal of the 2004 Bonds, plus interest accrued as of the redemption date:

<u>Redemption Period</u>	<u>Price</u>
June 20, 2008 to June 19, 2009 .....	102%
June 20, 2009 to June 19, 2010 .....	101%
June 20, 2010 and thereafter .....	100%

Additional bonds .....

The trust agreement dated September 28, 2000 between the Authority and Banco Popular de Puerto Rico (the "Trustee") as supplemented by that certain supplemental trust agreement to be dated the date of issuance of the 2004 Bonds (as amended, the "Trust Agreement"), under which the 2000 Bonds and the 2004 Bonds are issued, provides, subject to the approval of the Authority and TDF and to the fulfillment of certain conditions, for the issuance of additional bonds to complete the Project or to finance any addition, extension or improvement to the Project. Any such additional bonds issued will be entitled to the same benefits and security as the other bonds then outstanding under the Trust Agreement on the date of issuance thereof. The 2000 Bonds and the 2004 Bonds will be the only bonds outstanding under the Trust Agreement on the date of the issuance of the 2004 Bonds.

Trustee .....

Banco Popular de Puerto Rico.

Rating .....

Standard & Poor's: "BBB"

### **Tax Consequences**

In the opinion of Pietrantoni, Méndez & Alvarez LLP, Bond Counsel, assuming compliance by the Borrower with certain representations and covenants, under existing law:

- (1) the 2004 Bonds and the interest thereon are exempt from Puerto Rico income taxes and municipal property and license taxes;
- (2) under certain circumstances, the 2004 Bonds are exempt from Puerto Rico gift and estate taxes;
- (3) the interest on the 2004 Bonds is not subject to income tax under the United States Internal Revenue Code of 1986, as amended (the "Code") when received by:
  - (a) individuals who are *bona fide* residents of Puerto Rico during the entire taxable year in which such interest is received, and
  - (b) under certain circumstances, foreign corporations, including Puerto Rico corporations; and
- (4) the interest on the 2004 Bonds is not excludable from the gross income of the recipients thereof under Section 103(a) of the Code.

## **BONDHOLDERS' RISKS**

*Purchase of the 2004 Bonds involves certain risks. Prospective purchasers of the 2004 Bonds should give careful consideration to the matters referred below, as well as to other information set forth in this official statement before deciding to invest in the 2004 Bonds.*

### **A prepayment due to redemption may adversely affect your return on the Bonds**

The 2004 Bonds are subject to prepayment in advance of their stated maturity upon redemption and following an acceleration of their maturity or upon the failure of the Borrower to comply with certain covenants, and the resulting occurrence of an event of default, under the Loan Agreement, the Trust Agreement or the Reimbursement Agreement. The ability of the Borrower to comply with these covenants depends in part on the factors described in this "BONDHOLDERS' RISKS" section. In addition, the Reimbursement Agreement requires that the Borrower deposit eighteen point seventy-five percent (18.75%) of its annual excess cash flow, if any, at the time of distribution thereof to its partners into an excess cash flow reserve that can be applied to the optional redemption of Bonds. Furthermore, any Successor Letter of Credit may not be subject to automatic extension and may be for a term that is shorter than (i) the initial 15 year term of the TDF Letter of Credit or (ii) the term of the Bonds. In such event, the Bonds will be subject to mandatory redemption prior to maturity if the Borrower is unable to extend, renew or replace such Successor Letter of Credit prior to its expiration.

In addition, the Borrower is obligated to cause Desarrolladora del Norte, S. en C., S.E. ("Desarrolladora del Norte"), a Puerto Rico mercantile limited partnership that owns the Paradisus Puerto Rico Hotel, to subordinate its right of first refusal encumbering the land where the Project is located to the expansion of the mortgage securing the Bonds pursuant to a deed of subordination (the "Deed of Subordination"). Failure to secure the Deed of Subordination, and the corresponding resolution evidencing the authority of the person executing the Deed of Subordination on Desarrolladora del Norte's behalf, from Desarrolladora del Norte within sixty (60) days from August 20, 2004 will constitute an event of default under the Reimbursement Agreement entitling TDF to accelerate the maturity of the 2004 Bonds, thereby causing a prepayment in advance of the Bonds.

The Borrower may, or must, in certain cases, redeem or prepay some or all of the 2004 Bonds at times when prevailing interest rates may be low. If this happens, you generally will not be able to reinvest the proceeds you receive in a comparable security at an effective interest rate as high as that of the 2004 Bonds.

### **If Borrower is unable to pay the Bonds, payment of the Bonds will depend on the financial condition of the Letter of Credit Issuer**

Payment of the principal of and interest on the Bonds is secured by the Letter of Credit issued by the Letter of Credit Issuer. Payment of the Bonds will depend, to the extent the Borrower's financial condition does not permit it to pay the Bonds, upon the financial condition of the Letter of Credit Issuer. There can be no assurance that TDF or any Successor Letter of Credit Issuer will maintain its financial condition during the life of the Bonds.

The ability of TDF to meet its obligations under the TDF Letter of Credit is directly related to its capital and allowances for losses on guarantees and letters of credit, supplemented by fees paid by the obligors under debt guaranteed by it, investment income, legislative appropriations, and losses incurred in other tourism projects. On October 2001, the board of directors of the Government Development Bank for Puerto Rico approved a capital contribution of \$50 million to TDF, which was funded on November 2001, to add to the original \$50 million contributed in 1993 when TDF was constituted. As of June 30, 2003, the unrestricted net assets of TDF were approximately \$96.1 million, and its allowance for losses on guarantees and letters of credit was approximately \$28.3 million. As of the date of this official statement, TDF has outstanding executed loan agreements, guaranty agreements, letters of credit and loans with respect to the financing of several hotel and tourism related projects in the aggregate outstanding principal amount of approximately \$564.5 million.



TDF has made payments under its guarantees and letters of credit in the aggregate amount of approximately \$216.7 million with respect to several projects, including repayment in full of the bonds of three projects, which bonds had been declared due and payable at the direction of TDF due to the failure by the borrower of such projects to comply with its obligations under the related reimbursement agreement. After taking into consideration these payments and all related recoveries, the unrestricted net assets of TDF as of June 30, 2004 were approximately \$92.4 million (unaudited), and its allowance for loan losses on guarantees, loans and letters of credit was approximately \$36.4 million (unaudited).

No assurance can be given that TDF will have sufficient capital and allowances, generate earnings or receive appropriations to meet its obligations under the TDF Letter of Credit. Pursuant to the legislation under which TDF was created, each year, the Executive Director of TDF is required to certify to the Director of the Puerto Rico Office of Management and Budget, on or before December 31 of each year, the amount, if any, deemed necessary to reimburse TDF for sums disbursed during the previous year, in excess of certain earnings of TDF from fees and charges collected in connection with the issuance of guarantees or letters of credit, to cover the payment of principal of and interest on obligations guaranteed by TDF. The Director of the Puerto Rico Office of Management and Budget is required to include the amount so certified in the Puerto Rico General Budget for the following fiscal year. The Legislature of Puerto Rico, however, is not legally obligated to appropriate funds for TDF. TDF submitted its first reimbursement request to the Office of Management and Budget on September 2003 for \$21.4 million. To date, TDF has not received the requested funds. For further information about TDF, see "THE LETTER OF CREDIT AND THE TOURISM DEVELOPMENT FUND-TDF" and "Appendix D." For information concerning the requirements of a Successor Letter of Credit, see "SUMMARY OF THE LOAN AGREEMENT- Successor Letter of Credit."

#### **There are financial and operational risks related to the Project**

The Borrower was organized on December 30, 1999, has no significant operating history and will have no significant assets other than the Project. The ability of the Borrower to comply with its obligations under the Loan Agreement and the Reimbursement Agreement depends primarily upon the operating revenues and expenses of the Project, which are subject to conditions that may change in the future to an extent that cannot be determined at this time. Conditions which may affect the Project's future operating revenues and expenses include inflation and other economic conditions, population and demographic trends, the cost and availability of labor, the cost and availability of utilities, transportation costs and occurrence of natural disasters. The Project's future operating revenues will also depend on the Borrower's obtaining and maintaining certain permits, licenses and endorsements by various agencies of the Government of Puerto Rico. Except for certain debt service reserves and the security for the Bonds which may be available to pay the Bonds at any given time as described herein, the Borrower will have no other assets or sources of revenue for the payment of the Bonds. If the Borrower fails to meet its obligations under the Loan Agreement or the Reimbursement Agreement, under certain conditions, the Letter of Credit Issuer has the right to direct the Trustee to accelerate the Bonds, which would cause an early prepayment of the Bonds.

#### **There are development and construction risks related to the Project**

Although one of the two 18-hole golf courses that comprise the Project opened in March 2004, the completion of the construction of the Project as a whole is behind original schedule approximately 21 months. As of the date hereof, it is expected that construction of the second 18-hole golf course and the clubhouse will be completed by December 31, 2004. Until such time as the Project is completed, the Borrower's only revenues will be derived from the operation of the first 18-hole golf course. The completion of the Project involves risks that are beyond the control of the Borrower, including the shortage of building materials, strikes, natural disasters, competitive factors, general economic conditions, government regulations, and general domestic and international political conditions, and as a result there can be no assurances that the Project will be completed within the estimated revised schedule. Through the date hereof, the development and construction of the Project has exceeded the original budget of \$39.8 million for such construction by approximately \$14 million.

The opening of the clubhouse and second golf course will require the Borrower to obtain certain permits, approvals and consents from certain governmental agencies. The inability of the Borrower to obtain one or more of such approvals may delay or hinder the completion of the Project.

The Borrower depends on the Construction Manager to supervise the construction and development of the Project. The Borrower is subject to risks relating to the Construction Manager's ability to supervise the contractors to be engaged in the construction of the Project, keep Project costs within the construction budget, and to complete the work in a timely manner. The Construction Manager or the contractors' failure to comply with their respective obligation(s) may delay or hinder the completion of the Project.

In the event the costs of the Project exceed the budget (which includes reserves), the Borrower has no committed source of additional funding, other than a completion guaranty of Betterroads. The costs of the Project may exceed the budget (including reserves) in the event of unforeseen circumstances that require substantial changes to the development plan for the Project and, accordingly, to its plans and specifications. Consequently, the Borrower may have to modify the Project as previously proposed or delay its completion until additional funding is secured. The Reimbursement Agreement restricts the Borrower's ability to borrow additional funds. If, despite these restrictions, the Borrower is able to borrow additional funds, such loans would have to be repaid, with interest, which may create further operating deficits for the Project.

#### **Borrower may need future capital funds for the maintenance and modernization of the Project**

Facilities such as the Project are capital intensive and, in order to remain attractive and competitive, must be maintained as well as periodically modernized and refurbished. This creates an ongoing need for capital funds. The results of the Project will therefore be affected by the cost and availability of these funds. There can be no assurance that the Borrower will have sufficient reserves to meet such capital requirements or that the Borrower will have access to other sources of funds to meet such capital requirements.

#### **There is substantial competition in the resort and golf industry**

Both present and future resorts hotels in Puerto Rico and the Caribbean, which include golf facilities and other stand-alone golf facilities, may impact the profitability of the Project. Competition in Puerto Rico may increase in the future due to the development efforts in the hotel and tourism industry of the Government of Puerto Rico and the many tax and investment incentives being offered to attract such development. Future competition may also be affected by periodic overbuilding and changes in market conditions, or travel patterns and preferences.

#### **If Borrower is unable to maintain adequate insurance, future losses may not be fully recovered**

Certain types of losses, such as those resulting from hurricanes, floods and earthquakes, may not be economically insurable up to the Project's full economic value, and there can be no assurance that the Borrower will be able to maintain adequate insurance for all risks at reasonable costs and/or suitable terms. As a result, there can be no assurance that, in the event of a catastrophic or substantial loss, the Project's insurance would be sufficient to pay the full current market value or current replacement cost of the Project.

#### **The terms of the Management Agreement were negotiated by affiliated entities**

Accordingly, the terms, provisions and compensation contained in the Management Agreement may not reflect the fair market value of the services rendered by the golf course operator.

#### **The Borrower is subject to various conflicts of interest**

The Borrower is subject to various conflicts of interest arising out of its relationship with the Managing Partner, the Construction Manager and the golf course operator, and Betterroads and its affiliates which own equity interests in the two hotel projects that are expected to be constructed adjacent to the Project and that represent a principal source of customers for the Project. Such conflicts could result in certain actions or decisions that could have an adverse effect on the Borrower.

### **Dependence on the adjacent hotels exposes the Borrower to certain risks related to the hotel and tourism industry**

The principal source of customers for the Project will be the Paradisus Puerto Rico Hotel and up to two other hotel properties expected to be constructed adjacent to the Project. The financing, construction and operation of such hotels are independent of the financing, construction and operation of the Project. The Borrower has no control over this process and no assurance can be given that this process will be concluded on a satisfactory basis or that it will be concluded on a timely basis. Any failure or delay in the construction of, or inability to operate such hotel facilities as currently contemplated, could result in the Project lacking the expected source of customers, and therefore, materially and adversely affect the Project. Because of the expected dependence on the adjacent resort hotels, it is expected that the Project's revenues will be affected by the seasonal fluctuations affecting the hotel industry in Puerto Rico.

### **The Borrower will rely on the golf course operator to manage and operate the Project**

The Borrower executed the Management Agreement with the golf course operator. If the Management Agreement is terminated as a result of a default or other reason, or if the golf course operator decides not to renew the Management Agreement, a new operator would have to be obtained. There is a possibility that a new operator would be obtained on terms not as favorable to the Borrower as those set forth in the Management Agreement. In addition, there is a possibility that a new operator may not be obtained resulting in an event of default under the Reimbursement Agreement and, under certain circumstances, entitling the Letter of Credit Issuer to direct the Trustee to accelerate the Bonds. See "SUMMARY OF THE REIMBURSEMENT AGREEMENT."

### **The Borrower will depend on the private utility company for the treatment of its waste-water and irrigation**

For the treatment of its waste water and for the cost-effective irrigation of the golf courses, the Project will depend on the operation of a new waste water treatment plant, which also provides services to the Paradisus Puerto Rico Hotel and will provide services to other Resort developments. These services are being provided by a private utility company (the "Utility Company") which is a subsidiary of Betterroads. The operation of the plant will depend on a variety of factors not directly or indirectly within the control of the Borrower, such as obtaining and maintaining permits and licenses and securing future capital funds for its maintenance and refurbishment.

Neither the Utility Company nor Betterroads has previous experience in the business of waste water treatment. The Project has no current alternative source for waste water treatment, and alternative sources of water for irrigation of the golf courses may be more expensive than water from the new waste water treatment plant. If for any reason the new waste water treatment plant is not operated as required for the adequate treatment and discharge of waste water generated by the Project and irrigation thereof, the Project may not be able to operate, or may not be able to do so on a timely or cost effective basis.

### **The Borrower is subject to certain environmental risks**

Under various federal and Puerto Rico environmental laws, ordinances and regulations, the Borrower may be liable for the costs of removal or remediation of hazardous or toxic substances within the Project site. Such laws often impose liability whether the Borrower knew of, or was responsible for, the presence of such hazardous or toxic substances. In addition, persons who arrange for the disposal or treatment of hazardous or toxic substances may also be liable for the costs of removal or remediation of such substances at the disposal or treatment facility, whether such facility is or ever was owned or operated by such person.

### **The enforcement of remedies against the Borrower may be limited by bankruptcy and other laws**

If the Letter of Credit Issuer fails to honor any claim made and presented pursuant to and in strict compliance with the Letter of Credit, the Trustee may proceed to enforce any remedies under the Trust Agreement, the Loan Agreement and the Security Agreements. The enforcement of such remedies may be limited or restricted by laws relating to bankruptcy and rights of creditors generally and by general principles of equity applicable to the availability of certain remedies and may be substantially delayed and subject to judicial discretion in the event of litigation or statutory remedy.

procedures. Furthermore, no assurance can be given that the proceeds of any sale of the Project and the assets of the Borrower upon foreclosure would be sufficient to pay the outstanding principal and interest on the Bonds. See “SOURCES OF PAYMENT AND SECURITY FOR THE BONDS.” The various legal opinions to be delivered concurrently with the delivery of the Bonds will be qualified as to the enforceability of the various legal instruments by reference to limitations imposed by bankruptcy, reorganization, insolvency, moratorium or other similar laws affecting the rights of creditors and the availability of equitable remedies. Any such limitations, if imposed, may adversely affect the ability of the Trustee and the Bondholders to enforce their claims and assert their rights against the Borrower.

#### **Payments relating to Event of Taxability not covered by the Letter of Credit**

The Borrower has covenanted that during each taxable year it will conduct its business so that at all times interest payable on the Bonds will constitute income from sources within Puerto Rico for purposes of the Code, as in effect on the date of initial issuance and delivery of the Bonds (the “Source of Income Requirements”). Failure to comply with the Source of Income Requirements (an “Event of Taxability”) could cause interest on the Bonds to be included in the gross income of certain recipients for federal income tax purposes. Any remedies that Bondholders may have for violation of the Source of Income Requirements would have to be pursued by Bondholders directly against the Borrower. The TDF Letter of Credit does not cover any amount which may be required to be paid by the Borrower to Bondholders as result of such an Event of Taxability.

#### **The future value of the Bonds may be affected by the absence of a secondary market for the Bonds or by a negative change in the rating of the Bonds**

There is currently no secondary market for the Bonds, and there can be no assurance that a secondary market will develop, or if it does develop, that it will provide Bondholders with liquidity for their investment or that it will continue for the life of the Bonds. There is no assurance that the investment grade rating initially assigned to the Bonds will not be lowered or withdrawn, which could adversely affect the value of and market for the Bonds. See “RATING.”

### **FORWARD-LOOKING STATEMENTS**

This official statement contains certain “forward-looking statements” concerning the Borrower’s operations, performance and financial condition, including its future economic performance, plans and objectives and the likelihood of success in developing and expanding its business. 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 Borrower. 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.

### **THE AUTHORITY AND GOVERNING BOARD**

#### **The Authority**

The Authority is a body corporate and politic constituting a public corporation and governmental instrumentality of Puerto Rico. The Legislature of Puerto Rico determined that the development and expansion of commerce, industry and health and educational services within Puerto Rico are essential to the economic growth of Puerto Rico and to attain full employment and preserve the health, welfare, safety and prosperity of all its citizens. The Legislature also determined that new methods of financing capital investments were required to promote industry in Puerto Rico. Accordingly, the Authority was created under Act No. 121 of the Legislature of Puerto Rico, approved June 27, 1977, as amended (the “Act”), for the purpose of promoting the economic development, health, welfare and safety of the citizens of Puerto Rico. The Authority is authorized to borrow money through the issuance of revenue bonds and to loan the proceeds thereof to finance the acquisition, construction and equipping of industrial, tourist, educational, medical, pollution control and solid waste disposal facilities. The Authority has no taxing power. The Authority’s offices are

located at Minillas Government Center, De Diego Avenue, Stop 32, San Juan, Puerto Rico 00940. The Authority's telephone number is (787) 729-6000.

**Governing Board**

The Act provides that the governing board of the Authority (the "Governing Board") shall consist of seven members. The President of Government Development Bank for Puerto Rico ("GDB"), the Executive Director of the Puerto Rico Industrial Development Company, the Executive Director of Puerto Rico Infrastructure Financing Authority, the President of the Puerto Rico Environmental Quality Board and the Executive Director of the Puerto Rico Tourism Company are each *ex officio* members of the Governing Board. The remaining two members of the Governing Board are appointed by the Governor of the Commonwealth for terms of four years (one of such positions is currently vacant). The following individuals are the current members of the Governing Board:

<u>Name</u>	<u>Position</u>	<u>Term</u>	<u>Occupation</u>
Antonio Faría-Soto	Chairperson	Indefinite	President, Government Development Bank for Puerto Rico
Esteban Mujica Coto	Member	Indefinite	President, Puerto Rico Environmental Quality Board
José M. Suárez	Member	Indefinite	Executive Director, Puerto Rico Tourism Company
Hiram Ramírez Rangel	Member	Indefinite	Executive Director, Puerto Rico Industrial Development Company
Roxana Santaella	Member	Indefinite	Executive Director, Puerto Rico Infrastructure Financing Authority
Manuela Muñoz	Member	July 7, 2006	Attorney-at-law

The Act provides that the affirmative vote of four members is sufficient for any action taken by the Governing Board.

The following individuals are currently officers of the Authority:

*Carlos M. Piñero*, Executive Director of the Authority, is also Executive Vice President of GDB. He was appointed to these positions in 2002. Mr. Piñero received a Master in Business Administration from the University of Michigan Business School and a Bachelor of Science in Industrial Engineering from Lehigh University. Prior to this appointment, he worked in investment banking in Chicago, Illinois and was Executive Vice President of a Puerto Rico health care institution.

*Minia González Álvarez*, Assistant Executive Director of the Authority, is also Senior Vice President and the Director of the Compliance Department at GDB, a position she assumed in 2001. Prior to that, Ms. González worked at the Puerto Rico Housing Finance Corporation, a subsidiary of GDB, where she held various positions since 1988, including the position of Executive Director. Ms. González received a law degree from the Inter-American University of Puerto Rico in 1973.

*Olga Ortiz*, Assistant Secretary of the Authority, is also Secretary of the following boards of directors: GDB, TDF, Puerto Rico Public Finance Corporation, Puerto Rico Development Fund, Economy and Finance Institute José M. Berrocal and Puerto Rico Infrastructure Financing Authority. Ms. Ortiz has been associated with GDB since 1969. She received a bachelors degree in Business Education from the University of Puerto Rico and a Masters of Arts degree in Business Education from the Interamerican University.

## **Outstanding Revenue Bonds and Notes of the Authority**

As of June 30, 2004, the Authority had revenue bonds and notes outstanding in the principal amount of approximately \$2,152,639,914.

All such bond and note issues have been authorized and issued pursuant to trust agreements or resolutions separate from and unrelated to the Trust Agreement relating to the Bonds and are payable from sources other than the payments under the Loan Agreement.

Under the Act, the Authority may issue additional bonds and notes from time to time to finance industrial, tourist, educational, medical, pollution control or solid waste facilities. However, any such bonds and notes would be authorized and issued pursuant to other trust agreements or resolutions separate from and unrelated to the Trust Agreement relating to the Bonds and would be payable from sources other than the payments under the Loan Agreement.

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

As required by Act No. 272 of the Legislature of Puerto Rico, approved May 15, 1945, as amended, GDB has acted as a financial advisor to the Authority in connection with the issuance and sale of the Bonds.

GDB is a public corporation with varied governmental financial functions. Its principal functions are to act as financial advisor to and fiscal agent for Puerto Rico, its municipalities and its public corporations in connection with the issuance of bonds and notes, to make advances to public corporations and to make loans to private enterprises that will aid in the economic development of Puerto Rico

## **THE BORROWER**

The Borrower is a partnership organized under the laws of Puerto Rico that has elected to be treated as a special partnership in accordance with the provisions of the Puerto Rico Internal Revenue Code of 1994, as amended, and Act No. 3 of September 27, 1985, as amended. Pursuant to such election, the liability of the partners of the Borrower is limited to their paid-in capital. The partners of the Borrower are Betteroads which owns an 83% partnership interest, PFP Coco Beach L.P., an affiliate of Willowbend which owns a 7% partnership interest, and Mr. Arturo Díaz, Jr. who owns a 10% partnership interest. Betteroads is the largest asphalt producing and paving company in the Caribbean and owns and is otherwise engaged together with certain subsidiaries in the development of the Resort. Willowbend is a privately held company which specializes in the ownership, building, development and management of golf courses and hospitality related facilities. Mr. Arturo Díaz is the owner of Betteroads. For a more detailed description of the Borrower and its operations, see Appendix A.

## THE PROJECT

The Project will be comprised of two 18-hole championship signature golf courses, a clubhouse and related facilities being developed on approximately 520 “cuerdas” on the northeast coast of Puerto Rico, which are intended to be developed as a resort community. The Project will provide four different golf playing experiences. It will consist of four 9-hole half courses with different settings: mountains, oceansides, wetlands and lakeside settings. The Project is located adjacent to the Paradisus Puerto Rico Hotel, which is a 486-room luxury beach hotel and resort which opened to the public in March 2004. The Borrower has entered into a Use and Access Agreement to allow guests staying at the Paradisus Puerto Rico Hotel to use the Project’s facilities. The Project will also be open for limited outside resort, local and tournament play. In addition, the Project will offer both golf and social membership programs. Within the Resort, there are two additional parcels intended to be developed as hotels and luxury residential housing units.

The Borrower will use the proceeds of the 2004 Bonds to finance, in part, the additional costs necessary for the completion of the Project, including deposits into the debt service reserve fund and to pay certain costs of issuance. The following details the actual and future sources and uses of funds to develop the Project since its inception:

### Sources of Funds

Equity	
Land (1)	\$ 9,400,000.00
Cash Contribution from Partners (2)	18,660,579.68
Sale of Tourism Tax Credits	<u>1,342,465.20</u>
Total Equity	\$ 29,403,044.88
Debt	
Principal Amount of 2000 Bonds (3)	17,929,590.20
Principal Amount of 2004 Bonds	<u>7,497,854.10</u>
Total Debt	\$ 25,427,444.30
Total Sources	<u><u>\$ 54,830,489.18</u></u>

### Uses of Funds

Land Cost	\$ 9,400,000.00
Construction	37,000,000.00
Debt Service Reserve Fund	1,141,868.78
Operating Deficit Reserve Fund A	1,320,000.00
Operating Deficit Reserve Fund B	2,300,000.00
Capitalized TDF Fee Fund (5)	519,511.16
Capitalized Interest Fund (4)	1,195,249.87
Cost of Issuance (6)	980,899.93
Underwriter's Discount	423,253.94
AFICA Fee	254,978.54
TDF First Month Fee	13,099.48
Title Insurance Fee	50,525.00
TDF Upfront Fee	63,750.00
Mortgage Recording Fee	167,172.50
Additional Proceeds	<u>179.98</u>
	<u><u>\$ 54,830,489.18</u></u>

(1) Represents 471 cuerdas of land at appraised value. Source: Robert F. McCloskey Associates land appraisal dated February 28, 2000.

(2) Of this amount, approximately \$12.4 million was contributed on September 28, 2000 and approximately \$5.9 million will be contributed by the date of issuance of the 2004 Bonds.

- (3) Net of 2000 Bonds original issue discount.
- (4) Represents a portion of the interest accruing on the Bonds through March 20, 2003. These moneys will be deposited in the Bond Fund.
- (5) Represents a portion of the letter of credit fees payable to TDF through March 20, 2003. These moneys were deposited in the Construction Fund.
- (6) Includes fees payable to TDF on the date of issuance of the Bonds, mortgage recording fees and title insurance fees.

## **THE 2004 BONDS**

### **General**

The 2004 Bonds will be issued under the Trust Agreement. The 2004 Bonds will be dated the date of delivery thereof, will have yields or bear interest, as applicable, and will mature (subject to the rights of redemption described below) on December 20, 2034. Yield and interest on the 2004 Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months.

The 2004 Bonds will be issued as fully registered bonds without coupons in the denomination of \$5,000, or any integral multiples thereof. Interest on the 2004 Bonds will accrue from the date of issuance until December 20, 2034 at an annual fixed rate of 6.00%. The 2004 Bonds will be registered under the DTC book-entry only system described below. Therefore, you will not receive a certificate for any 2004 Bonds you purchase. The principal or redemption price of and interest on the 2004 Bonds will be payable as described below under “Book-Entry Only System.”

For purposes of this Official Statement, references to “principal” shall mean the appreciated value thereof, unless otherwise expressly stated.

Interest on the 2004 Bonds initially will not be paid and will be added to the principal of such Bonds semiannually on each December 20 and June 20 until the Conversion Date. Appendix C-1 of this Official Statement sets forth the appreciated value of the 2004 Bonds. Upon termination of the Accretion Period, interest on the accreted principal amount outstanding of the 2004 Bonds will be paid semiannually on each Payment Date. On each Payment Date on which interest is paid, interest will be calculated on the basis of the principal amount outstanding after giving effect to the distributions of principal made on the prior Payment Date. No payments of principal will be made on the 2004 Bonds prior to the Conversion Date. On Payment Date occurring after the Conversion Date, payments of principal will be made in the amounts set forth on Appendix C-2.

Payments of principal, premium, if any, and interest on the Bonds must be made with Eligible Moneys. As used herein, “Eligible Moneys” means with respect to any day on which any payment of principal, premium, if any, and interest is required to be made on the Bonds: (i) all amounts drawn by the Trustee under the Letter of Credit, or otherwise received from the Letter of Credit Issuer, and deposited to the credit of the Bond Fund or the Debt Service Reserve Fund; (ii) all amounts in respect of accrued interest, if any, deposited to the credit of the Bond Fund from the proceeds of the initial sale of the Bonds; (iii) all amounts in respect of capitalized interest deposited to the credit of the Bond Fund from the proceeds of the initial sale of the Bonds and used by the Trustee to pay a portion of the interest due on the Bonds during the construction of the Project; (iv) all other amounts on deposit in the Construction Fund, the Bond Fund or the Debt Service Reserve Fund prior to the termination of the Letter of Credit: (a) to the extent such amounts constitute proceeds of the Bonds deposited with the Trustee contemporaneously with the issuance and sale of the Bonds, or investment income generated by the funds described in (i) to (iii) above or this clause (iv), deposited in the Debt Service Reserve Fund and the Construction Fund, or which have been on deposit with the Trustee in such separate and segregated accounts or sub-accounts in which no other moneys are held for a period of ninety-four (94) consecutive days prior to the applicable payment date without the occurrence of an intervening Act of Bankruptcy (as defined in the Trust Agreement); or (b) as to which the Trustee has received an opinion of counsel experienced in bankruptcy matters to the effect that payment to the Bondholders of such moneys would not constitute a transfer that may be voided as a preference under any provision of the United States Bankruptcy Code in the event of an Act of Bankruptcy; and (v) after expiration



of the Letter of Credit, the Bonds still being outstanding, all amounts on deposit in any fund under the Trust Agreement from whatever source.

### **Book-Entry Only System**

The following information concerning DTC and DTC's book-entry system has been obtained from DTC, and the Authority, the Borrower and TDF do not take any responsibility for the accuracy thereof.

DTC will act as securities depository for the Bonds. The 2004 Bonds will be issued as fully registered Bonds in the name of Cede & Co., DTC's partnership nominee. One fully registered 2004 Bond will be issued in the aggregate principal amount of the 2004 Bonds, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities and Exchange Act of 1934, as amended. DTC holds securities that its participants (the "Direct Participants") deposit with DTC. DTC also facilitates the settlement of securities transactions among Direct Participants, such as transfers and pledges, in deposited securities through electronic book-entry changes in accounts of the Direct Participants, thereby eliminating the need of physical movement of securities. Direct Participants include security brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as banks, brokers, dealers and trust companies that clear transactions through or maintain a custodial relationship with Direct Participants, either directly or indirectly (the "Indirect Participants" and, together with the Direct Participants, the "Participants"). The rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchase of Bonds under the DTC system must be made by or through Direct Participants which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of the Bonds ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmations from DTC of their purchase, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interest in the 2004 Bonds, except in the event that use of the DTC system for the Bonds is discontinued.

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

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

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

Neither DTC nor Cede & Co. will consent or vote with respect to the Bonds. Under its usual procedures, DTC mails an "Omnibus Proxy" to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy). **Certain actions for which a vote of the Beneficial Owners is required under the Trust Agreement are also subject to the consent of the Letter of Credit Issuer, which has**

**issued the Letter of Credit to secure payment of principal of and interest on the Bonds as more fully described herein.**

Principal of and redemption premium, if any, and interest payments on the Bonds will be made to DTC, DTC's practice is to credit Direct Participants' accounts on each Payment Date in accordance with their respective holdings shown on DTC's record unless DTC has reason to believe that it will not receive payment on such date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, the Trustee, the Borrower, the Letter or Credit Issuer or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Trustee, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of Direct and Indirect Participants.

Each person for which a Participant acquires an interest in the Bonds, as nominee, may desire to make arrangements with such Participant to receive a credit balance in the records of such Participant, and may desire to make arrangements with such Participant to have all notices of redemption or other communication to DTC which may affect such person forwarded in writing by such Participant and to have notification made of all interest payments.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time given reasonable notice to the Authority or the Trustee. In such event, the Authority will try to find a substitute securities depository and, if unsuccessful, definitive Bonds will be printed and delivered. In addition, the Authority, in its sole discretion and without the consent of any other person, may terminate the services of DTC as securities depository with respect to the Bonds if the Authority determines that Beneficial Owners of such Bonds shall be able to obtain definitive bonds. In such event, definitive Bonds will be printed and delivered as provided in the Trust Agreement and registered in accordance with the instructions of the Beneficial Owners.

So long as Cede & Co., as nominee of DTC (or any other nominee of DTC), is the registered owner of the Bonds, all references herein to the Bondholders or registered owners of the Bonds (other than under heading "TAX MATTERS") shall mean Cede & Co., or such other nominee, in the capacity of nominee for DTC, and shall not mean the Beneficial Owners of the Bonds.

When reference is made to any action which is required or permitted to be taken by the Beneficial Owners, such reference shall only relate to those permitted to act (by statute, regulation or otherwise) in behalf of such Beneficial Owners for such purposes. When notice are given, they shall be sent by the Authority or the Trustee to DTC only.

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

THE AUTHORITY, THE TRUSTEE, THE LETTER OF CREDIT ISSUER AND THE BORROWER SHALL HAVE NO RESPONSIBILITY OR OBLIGATION TO ANY PARTICIPANT OR ANY BENEFICIAL OWNER WITH RESPECT TO: (1) THE ACCURACY OR ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT, AS DESCRIBED ABOVE; (2) THE PAYMENTS OR TIMELINESS OF PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OR REDEMPTION PRICE OF OR INTEREST ON THE BONDS; (3) THE DELIVERY OR TIMELINESS OF DELIVERY BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY NOTICE TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE TRUST AGREEMENT TO BE GIVEN TO BONDHOLDERS; (4) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE BONDS; OR (5) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS BONDHOLDER.

In the event that the book-entry only system is discontinued and the Beneficial Owners become registered owners of the 2004 Bonds, the following provisions will apply: The principal of the 2004 Bonds and premium, if any, thereon when due will be payable upon presentation of the 2004 Bonds at the corporate trust office of the Trustee in San

Juan, Puerto Rico, and interest on the 2004 Bonds will be paid by check mailed to the person who were the registered owners os of the fifth (5<sup>th</sup>) day of the month that contains the related payment date, as provided in the Trust Agreement. The 2004 Bonds may be exchanged for an equal aggregate principal amount of 2004 Bonds in other authorized denominations and of the same maturity and interest rate, upon surrender thereof at the Trustee's corporate trust office in San Juan, Puerto Rico. The transfer of any 2004 Bond may be registered only upon surrender thereof of the Trustee along with a duly executed assignment in the form satisfactory to the Trustee. Upon any such registration of transfer, a new 2004 Bond or 2004 Bonds of authorized denominations in an equal aggregate principal amount, of the same maturity, bearing interest at the same rate and registered in the name of the transferee will be executed by the Authority and authenticated by the Trustee. No charge may be made to the Bondholder requesting for any exchange or registration of transfer of the 2004 Bonds, but any Bondholder requesting any such changes shall pay any tax or other governmental charge required to be paid with respect to such exchange or registration of transfer. The Trustee will be required to exchange or to registered the transfer of any 2004 Bond during the period of 15 days preceding the date of giving of notice of redemption or after any bond or portion thereof has been selected for redemption.

### **Additional Bonds**

The Trust Agreement provides for the issuance of Additional Bonds to complete the Project or to finance any addition, extension or improvement to the Project. Any such Additional Bonds will have such maturities, bear interest at such rates, be subject to redemption at such times and shall otherwise be subject to such terms and conditions as are set forth in the resolution of the Authority providing for the issuance of Additional Bonds.

As a condition precedent to the issuance of any Additional Bonds, S&P must confirm that the issuance of Additional Bonds will not result in a withdrawal, suspension or reduction of the then current rating on the Bonds and that such Bonds will not be rated below "BBB". S&P has confirmed that the issuance of the 2004 Bonds will not result in a withdrawal, suspension or reduction of the current rating of the 2000 Bonds and that the 2004 Bonds will not be rated below "BBB". Any Additional Bonds issued, including the 2004 Bonds, will be entitled to the same benefits and security as the other Bonds then outstanding.

### **Redemption**

#### **Mandatory Redemption**

The 2004 Bonds will be subject to mandatory redemption as described below.

*Excess Bond Proceeds.* The 2004 Bonds, will be subject to mandatory redemption, in part, at a price equal to the principal amount thereof plus accrued and unpaid interest up to the redemption date, without premium, to the extent of any funds remaining in the Construction Fund and transferred to the Bond Fund for the redemption of 2004 Bonds pursuant to the Trust Agreement, on the earlier of: (a) the third anniversary of the date of issuance of the 2004 Bonds (subject to extension by the Authority); (b) the date of completion of the Project as certified by the Borrower; or (c) receipt by the Trustee of a certificate signed by the Borrower and approved by the Authority and the Letter of Credit Issuer, certifying that the Project will not be completed. Such redemption shall be effected on the next interest payment date of the 2000 Bonds occurring not less than forty-five days after the date of said transfer and of sufficient Eligible Moneys on deposit with the Trustee to effect such redemption.

*Condemnation, Destruction or Damage of the Project.* The Bonds, including the 2004 Bonds, will be subject to mandatory redemption, in whole or in part, at a price equal to the principal amount thereof plus accrued and unpaid interest up to the redemption date, without premium, to the extent of any condemnation, casualty or insurance proceeds received by the Trustee, upon the occurrence of an event of condemnation, destruction of, or damage to, the Project to the extent such proceeds are not utilized for the repair and reconstruction of the Project in accordance with the terms and conditions set forth in the Pledge Agreement, as amended in connection with the issuance of the 2004 Bonds. Such redemption will occur on the next interest payment date occurring not less than forty-five (45) days after receipt by the Trustee of the notice required to be delivered by the Borrower under the Loan Agreement and of sufficient Eligible Moneys on deposit with the Trustee to effect such redemption.

*Expiration of Successor Letter of Credit.* The Bonds, including the 2004 Bonds, will be subject to mandatory redemption in whole, upon the failure of the Borrower to extend, renew or replace a Successor Letter of Credit on or prior to the sixtieth (60th) day preceding its expiration. Said redemption will be effected on the interest payment date immediately preceding the expiration date of the then outstanding Successor Letter of Credit.

A Successor Letter of Credit issued by a bank or other financial institution will not be subject to the requirement that it provide for automatic renewal, but may rather be for a fixed term renewable at the option of such bank or financial institution for minimum periods of one year.

*Amortization Requirements.* The 2004 Bonds outstanding at the time are subject to mandatory redemption in part commencing on December 20, 2008, and on each June 20 and December 20 thereafter, in amounts equal to the amortization requirements set forth in Appendix C-2 (less the principal amount of such 2004 Bonds previously retired by purchase or redemption).

The amounts deposited in the Bond Fund to satisfy the amortization requirements for the 2004 Bonds may be applied by the Trustee prior to the forty-fifth (45<sup>th</sup>) day preceding any date fixed for redemption to the purchase of the 2004 Bonds. In addition, the Borrower, at its option, may direct the Trustee to credit against the amortization requirement for the 2004 Bonds, the principal amount of 2004 Bonds purchased by the Borrower or the Trustee (otherwise than from moneys deposited in the Bond Fund), redeemed pursuant to the optional redemption provisions of the Loan Agreement and the Trust Agreement or delivered by the Borrower to the Trustee for cancellation.

### **Optional Redemption**

The 2004 Bonds may be redeemed by the Borrower at its option, in whole or in part, at any time on or after June 20, 2008, on any interest payment date selected by the Borrower occurring not less than ninety four (94) days from the date the notice of redemption is received by the Trustee, at the redemption prices set forth below which are expressed as percentages of the principal amount of such bonds, plus accrued interest to the redemption date:

<b><u>Redemption Period</u></b> <b>(All Dates Inclusive)</b>	<b><u>Price</u></b>
June 20, 2008 to June 19, 2009	102%
June 20, 2009 to June 19, 2010	101%
June 20, 2010 and thereafter	100%

To exercise the foregoing optional redemption, the Borrower must deposit with the Trustee moneys necessary to effect such redemption not later than the ninety-fourth (94th) day immediately preceding the date on which the corresponding redemption price is due and payable. The written consent of the Letter of Credit Issuer shall be required for any optional redemption in whole or in part if there exists an event of default or an event has occurred which if not cured would constitute an event of default under the Reimbursement Agreement. The Letter of Credit does not cover any premium payable in connection with any such optional redemption.

### **Selection and Notice of Redemption**

Except with respect to the mandatory redemption of the 2004 Bonds in accordance with the amortization requirements described above and the mandatory redemption of the 2000 Bonds in accordance with the amortization requirements described in the form of 2000 Bonds, (i) if less than all of the outstanding Bonds are called for redemption, the Bonds of each Series (as defined in the Trust Agreement) shall be redeemed pro-rata, based on the percentage that the outstanding Bonds of each Series has to the aggregate principal amount of Bonds of all Series then outstanding, and (ii) if less than all of the outstanding Bonds of a Series shall be called for redemption, the Bonds of such Series shall be redeemed inverse order of maturity unless otherwise requested by the Borrower and agreed to in writing by the Letter of Credit Issuer. If less than all Bonds of one maturity are called for redemption, the particular Bonds or portions thereof

to be redeemed will be selected by the Trustee by such method as the Trustee deems fair and appropriate in integral multiples of \$5,000 (\$5,000 maturity amount in the case of the 2004 Bonds).

At least thirty (30) days before any redemption date, notice thereof will be sent by the Trustee via first-class mail, postage prepaid, to the registered owners of the Bonds to be redeemed. Each notice of redemption shall set forth: (a) the redemption date; (b) the redemption price; (c) if fewer than all of the Bonds then outstanding shall be called for redemption, the distinctive numbers and letters, if any, of such bonds to be redeemed and, in the case of bonds to be redeemed in part only, the portion of the principal amount thereof to be redeemed; (d) that on the date fixed for redemption such redemption price will become due and payable upon each bond or portion thereof called for redemption, and that interest thereon shall cease to accrue on and after said redemption date; and (e) the place where such bonds or portions thereof called for redemption are to be surrendered for payment of such redemption price. In case the 2004 Bonds are to be redeemed in part only, the notice of redemption shall state also that on or after the redemption date, upon surrender of such bonds, a new bond or bonds in principal amount (or maturity amount) equal to the unredeemed portion of such bonds will be issued. Failure to mail such notice to any Bondholder or any defect in any notice so mailed shall not affect the validity of the proceedings for the redemption of the bonds of any other Bondholders.

If notice of redemption is given and if sufficient funds are on deposit with the Trustee to provide for the payment of the principal of and premium, if any, and interest on the 2004 Bonds (or portions thereof) to be redeemed, then the bonds (or portions thereof) so called for redemption will, on the redemption date, cease to bear interest (and the appreciated value shall cease to increase) and shall no longer be deemed outstanding or be entitled to any benefit or security under the Trust Agreement.

#### **SOURCES OF PAYMENT AND SECURITY FOR THE 2004 BONDS**

The 2004 Bonds are limited obligations of the Authority payable solely from revenues derived pursuant to the Loan Agreement, from funds drawn under the Letter of Credit, and from such other amounts as may be available to the Trustee under the Trust Agreement. The 2004 Bonds will not constitute a charge against the general credit of the Authority and will not constitute an indebtedness of the Government of Puerto Rico or any of its political subdivisions other than the Authority, with respect to the Bonds, and TDF, with respect to the TDF Letter of Credit. Neither the Government Development Bank for Puerto Rico nor any other affiliate of TDF is obligated to make payments under the TDF Letter of Credit. The partners and affiliates of the Borrower are not liable with respect to the payment of the 2004 Bonds.

The 2000 Bonds and the 2004 Bonds will have the same source of payment and will be secured by the same collateral, on a *pari passu* basis, as described below.

#### **The Loan Agreement**

The Loan Agreement executed between the Authority and the Borrower for the issuance of the 2000 Bonds was amended to provide for the issuance of the 2004 Bonds. Under the Loan Agreement, the Borrower will agree to deposit with the Trustee in the Bond Fund amounts sufficient to pay, together with the amounts on deposit therein, principal of, premium, if any, and interest on the Bonds when due. Such deposits are required to be made at least ninety-four (94) days prior to the date on which the corresponding amounts of principal, premium, if any, and interest on the Bonds are due and payable.

Pursuant to the Trust Agreement, the Authority will assign its interest in the Loan Agreement (except certain consent or approval rights and rights of the Authority to indemnification, exemption from liabilities, the right to receive notices and the payment of costs and expenses) to the Trustee as security for the Bonds. See "THE LOAN AGREEMENT."

## **Debt Service Reserve Fund**

On the date of issuance of the 2004 Bonds, the Borrower shall deposit from the proceeds of the Bonds to the credit of the Debt Service Reserve Fund in the amount of \$365,550. The cash deposited in the Debt Service Reserve Fund will be invested in securities and investment agreements that will provide at all times an amount at least equal to the maximum debt service on the Bonds during any six months period. Moneys held to the credit of the Debt Service Reserve Fund shall be used for the purpose of paying the principal of and interest on the Bonds when due, whenever and to the extent that moneys held to the credit of the Bond Fund shall be insufficient for such purposes. In accordance with the Loan Agreement, the Borrower has the obligation to replenish the Debt Service Reserve Fund within one Business Day of the existence of a Debt Service Reserve Fund Deficiency caused by the withdrawal of funds from the Debt Service Reserve Fund. If the Borrower fails to deposit an amount sufficient in the Debt Service Reserve Fund to meet the Debt Service Reserve Fund Requirement within such period of time, the Trustee shall make a draw under the Letter of Credit to pay the Debt Service Reserve Fund Deficiency on the second Business Day immediately after the Debt Service Reserve Fund Deficiency arises. Such draw shall be honored by the Letter of Credit Issuer on the July 15 or December 26 immediately succeeding the date on which such draw is made, so long as such draw was made and presented to it in strict compliance with the terms of the Letter of Credit.

The Borrower shall direct the Trustee to cause the moneys held in the Debt Service Reserve Fund to be invested in Investment Obligations (as defined in the Trust Agreement) of such long-term or short-term maturities as the Borrower elects; provided that such Investment Obligations deposited in the Debt Service Reserve Fund shall mature or be subject to redemption no later than the second Business Day preceding the Payment Date on which the funds could be needed. In the event of a reduction in the market value of the Investment Obligations held in the Debt Service Reserve Fund to an amount lower than the Debt Service Reserve Fund Requirement, the Borrower will also be required to replenish the Debt Service Reserve Fund within three (3) Business Days of receiving notice thereof. If the Borrower fails to deposit an amount sufficient in the Debt Service Reserve Fund to meet the Debt Service Reserve Fund Requirement within such period of time, the Trustee shall make a draw under the Letter of Credit to pay the Debt Service Reserve Fund Deficiency on the fourth Business Day immediately after the Debt Service Reserve Fund Deficiency arises. Such draw shall be honored by the Letter of Credit Issuer on the July 15 or December 26 immediately succeeding the date on which such draw is made, so as long as such draw was made and presented pursuant to and in strict compliance with the terms of the Letter of Credit.

## **The Pledge Agreement and the Mortgage**

The Bonds will be secured by a pledge of each of an interest bearing mortgage note in an aggregate principal amount equal to the principal amount of the 2000 Bonds (the "Original Mortgage Note") and an interest bearing mortgage note in an aggregate principal amount equal to the fully accreted principal amount of the 2004 Bonds (the "Additional Mortgage Note" and, together with the Original Mortgage Note, the "Mortgage Note"). The Mortgage Note will be secured by a first priority mortgage lien (as such mortgage is amended to reflect the issuance of the 2004 Bonds, the "Mortgage") on the real property comprising the Project (the "Property"), subject only to certain permitted encumbrances and, in the case of the Additional Mortgage Note, to Desarrolladora del Norte's right of first refusal for so long as the Deed of Subordination is not delivered in recordable form and filed for registration.

The Mortgage Note will be pledged to the Authority and the Letter of Credit Issuer pursuant to a Pledge and Security Agreement (as such agreement is amended to reflect the issuance of the 2004 Bonds, the "Pledge Agreement") as security for the obligations of the Borrower under the Loan Agreement and the Reimbursement Agreement, respectively. The Authority will assign its rights under the Pledge Agreement and the Mortgage Note to the Trustee for the benefit of the Bondholders.

A mortgagee title insurance policy insuring the Mortgage as a first priority lien on the Property, subject only to certain permitted encumbrances, will be delivered on the date of issuance of the 2004 Bonds in an amount equal to the principal amount of the Mortgage Note.

The Pledge Agreement contains covenants of the Borrower normally required of mortgagors with respect to properties similar to that of the Project, including covenants with respect to compliance with environmental laws and

regulations and maintenance of insurance. The Pledge Agreement permits the Borrower to restore or replace the Project or portions thereof in the event of any damage due to casualty or loss due to condemnation to the extent provided and upon compliance with the terms and certain conditions set forth therein.

### **Other Security Agreements**

The Bonds are additionally secured by the Security Agreements which create a first priority security interest in substantially all the personal property of the Borrower, including tangible personal property, accounts receivable, contractual rights, leases, subleases, concessions and other agreements related to the operations of the Project.

The Pledge Agreement and the other Security Agreements provide that so long as the Letter of Credit Issuer is in compliance with its obligations under the Letter of Credit, the Letter of Credit Issuer may modify, change or otherwise amend the Security Agreements without the consent of the Authority, the Bondholders or the Trustee. Any such change, amendment or modification shall be subject to the additional requirement that immediately thereafter the Authority or Letter of Credit Issuer continues to be a mortgagee of a first mortgage in the amount of the mortgage note on the land and buildings comprising the Project.

The Security Agreements may also be amended upon the issuance of Additional Bonds, to provide for the increase of the Mortgage Note in an amount sufficient to secure such Additional Bonds and to otherwise grant the Bondholders of such Additional Bonds equal rights and priority in the Mortgage Note and the other collateral securing the Bonds. The Security Agreement will be amended in accordance with the immediately preceding sentence on the date of delivery of the 2004 Bonds.

The Pledge Agreement and the other Security Agreements provide that in the event the Letter of Credit Issuer shall fail to honor any draw made and presented pursuant to and in strict compliance with the terms of the Letter of Credit, the Bondholders shall have control and access to such collateral (except to the extent of any outstanding reimbursement obligations under the Reimbursement Agreement). Accordingly, upon such failure by the Letter of Credit Issuer, if sufficient moneys were otherwise not available in the Bond Fund and the Debt Service Reserve Fund for the payment of principal of and interest on the Bonds, the Trustee may institute proceedings to cause the enforcement of security interests under the Security Agreements, including the foreclosure of the Pledge Agreement and the Mortgage.

## **THE TDF LETTER OF CREDIT AND THE TOURISM DEVELOPMENT FUND**

### **The TDF Letter of Credit**

On the date of issuance of the 2004 Bonds, the Borrower will cause TDF to amend and restate the TDF Letter of Credit issued in favor of the Trustee for the benefit of the Bondholders in order to increase its stated amount to secure the payment of principal and interest on the 2004 Bonds on a pari passu basis with the 2000 Bonds. The TDF Letter of Credit is an irrevocable transferable stand-by obligation of TDF to pay to the Trustee, upon request and in accordance with the terms thereof, an aggregate amount sufficient to pay when due (whether at maturity or upon acceleration or redemption) the principal amount of the Bonds outstanding and up to 195 days of accrued interest thereon. The Trust Agreement provides that two (2) Business Days prior to each payment date, the Trustee is required to make drawings under the Letter of Credit to the extent that sufficient Eligible Moneys are not otherwise available therefor in the Bond Fund or the Debt Service Reserve Fund to pay the principal amount of, and interest on the Bonds due on such payment date. The Trust Agreement further provides that whenever a Debt Service Reserve Fund Deficiency shall exist, the Trustee shall make a draw on the Letter of Credit to eliminate such deficiency, to the extent that funds have not been provided by the Borrower, on the second Business Day immediately following the date such Debt Service Reserve Fund Deficiency shall arise if such Debt Service Reserve Fund Deficiency was caused by a withdrawal of funds, or on the fourth Business Day immediately following the date such Debt Service Reserve Fund Deficiency shall arise if such Debt Service Reserve Fund Deficiency was caused by a loss resulting from a decline in the value of the Investment Obligations held to the credit of the Debt Service Reserve Fund. The Letter of Credit does not provide for payment of any redemption premium or for payment of any other amounts in connection with any other indemnity that may be required to be paid with respect to the Bonds.

Draws made under the TDF Letter of Credit relating to the payment of principal and interest on the Bonds shall be honored by the TDF Letter of Credit on the Business Day next succeeding the dates on which draws are made. A draw made under the TDF Letter of Credit relating to a Debt Service Reserve Fund Deficiency shall be honored by TDF on the July 15 or December 26 immediately succeeding such draw. If July 15 or December 26 is not a Business Day, the payment will occur on the immediately succeeding Business Day.

The obligations of TDF under the TDF Letter of Credit will be reduced to the extent of any payments made by the Borrower and any drawing thereunder, subject to automatic reinstatement and adjustment of amounts available to be drawn with respect to the payment of interest on the Bonds or a Debt Service Reserve Fund Deficiency; provided, however, that TDF may notify the Trustee following a drawing with respect to the payment of interest on the Bonds that a reinstatement will not occur because the Borrower has failed to reimburse TDF in respect of such drawing or that certain events of default under the Reimbursement Agreement have occurred and are continuing. The Trustee is required, upon receipt from TDF of such notice of non-reinstatement and of an amount sufficient, together with Eligible Monies on deposit with the Trustee, to pay the outstanding principal amount of and interest on the Bonds, and to declare the Bonds immediately due and payable (without prior notice to the Bondholders).

Upon the occurrence and continuance of certain events of default under the Reimbursement Agreement, TDF may notify the Trustee thereof and give a notice of termination with respect to the TDF Letter of Credit. The Trustee is required, upon receipt from TDF of such notice of termination and of an amount sufficient, together with Eligible Monies on deposit with the Trustee, to pay the outstanding principal amount of and interest on the Bonds, to declare the Bonds immediately due and payable (without prior notice to the Bondholders).

The TDF Letter of Credit expires on December 30, 2015, subject to earlier termination upon the occurrence and continuance of certain events of default under the Reimbursement Agreement. The TDF Letter of Credit will be automatically extended beyond its expiration date for three additional periods of five years each followed by an additional period of four years.

## **TDF**

TDF is a subsidiary of Government Development Bank for Puerto Rico ("GDB") and an instrumentality of the Government of Puerto Rico. TDF was created on November 17, 1993, pursuant to Resolution No. 6275, adopted by the Board of Directors of GDB. TDF was created for the purpose of promoting the hotel and tourism industry of Puerto Rico by making capital investments in, or by providing financing directly or indirectly to, entities that contribute or could contribute to the development of said industry. Under its enabling resolution, TDF is specifically authorized to issue, execute and deliver guarantees and letters of credit to secure payment on bonds. Pursuant to its enabling resolution, the initial capitalization of TDF was \$50,000,000. In accordance with the law pursuant to which it was created, the Board of Directors of TDF is composed of five members, namely, the President of GDB, the Executive Director of the Puerto Rico Tourism Company and the Secretary of the Treasury of Puerto Rico and two private sector members.

Pursuant to the legislation under which TDF was created, each year, the Executive Director of TDF is required to certify to the Director of the Puerto Rico Office of Management and Budget, on or before December 31 of each year, the amount, if any, deemed necessary to reimburse TDF for sums disbursed during the previous year, in excess of certain earnings of TDF from fees and charges collected in connection with the issuance of guarantees or letters of credit, to cover the payment of principal of and interest on obligations guaranteed by TDF. This legislation currently does not expressly provide for the reimbursement of losses incurred by TDF on loans made directly by TDF. TDF is evaluating submitting an amendment to this legislation to provide for the reimbursement of such losses. The Director of the Puerto Rico Office of Management and Budget is required to include the amount certified by the Executive Director of TDF in the Puerto Rico General Budget for the following fiscal year. The certificate issued by the Executive Director of TDF must be based on an evaluation of the disbursements made and the earnings from fees and charges collected by TDF and of the obligations of TDF for the coming year and shall be final. The payment of the amount so certified shall be subject to the consideration of the Puerto Rico Legislature, which is not legally obligated to appropriate funds for TDF.

The ability of TDF to meet its obligations under the TDF Letter of Credit is directly related to its capital, supplemented by fees paid by the issuers of debt guaranteed by it, investment income and legislative appropriations, net



of losses incurred in other tourism projects. On October 2001, the board of directors of the GDB approved a capital contribution of \$50 million to TDF, which was funded on November 2001, to add to the original \$50 million contributed in 1993 when TDF was constituted. As of June 30, 2003, the unrestricted net assets of TDF were approximately \$96.1 million, and its allowance for losses on guarantees and letters of credit was approximately \$28.3 million. As of the date of this official statement, TDF has outstanding executed loan agreements, guaranty agreements, letters of credit and loans with respect to the financing of several hotel and tourism related projects in the aggregate outstanding principal amount of approximately \$564.5 million.

TDF has made payments under its guarantees and letters of credit in the aggregate amount of approximately \$216.7 million with respect to several projects, including repayment in full of the bonds of three projects, which bonds had been declared due and payable at the direction of TDF due to the failure by the borrower of such projects to comply with its obligations under the related reimbursement agreement. After taking into consideration these payments and all related recoveries, the unrestricted net assets of TDF as of June 30, 2004 were approximately \$92.4 million (unaudited), and its allowance for loan losses on guarantees, loans and letters of credit was approximately \$36.4 million (unaudited).

No assurance can be given that TDF will have sufficient capital, generate sufficient earnings or receive sufficient appropriations to meet its obligations under the existing letters of credit and guaranty agreements, including the TDF Letter of Credit securing the Bonds. The Legislature of Puerto Rico is not legally obligated to appropriate funds for TDF. TDF submitted its first reimbursement request to the Office of Management and Budget on September 2003 for \$21.4 million. To date, TDF has not received the requested funds.

## **SUMMARY OF THE LOAN AGREEMENT**

The following briefly summarizes the material provisions of the Loan Agreement, as amended in connection with the issuance of the 2004 Bonds. This summary is not complete. You should read the more detailed provisions of the Loan Agreement for provisions that may be important to you. A copy of the Loan Agreement may be obtained from the Borrower prior to the issuance of the 2004 Bonds and, thereafter, from the Trustee.

The Loan Agreement provides for the financing of a portion of the costs of the Project. Pursuant to the Loan Agreement, the Authority issued the 2000 Bonds and will issue the 2004 Bonds and lent, and will lend in the case of the 2004 Bonds, the proceeds from the sale thereof to the Borrower. The Borrower will agree to make payments directly to the Trustee which, together with amounts then held in the Bond Fund established under the Trust Agreement, will be sufficient to make the payments of principal of and premium, if any, and interest on the Bonds as the same become due on an interest payment date, at maturity, upon redemption or acceleration. If sufficient Eligible Moneys are not deposited to the credit of the Bond Fund to cover the principal of and premium, if any, and interest on the Bonds when due and payable on any payment date, the Trustee is authorized to transfer Eligible Moneys from the Debt Service Reserve Fund to the Bond Fund in the amount necessary to pay the principal of and interest due or to become due on each such payment date. The Borrower must replenish any amount so transferred. See "SOURCES OF PAYMENT AND SECURITY FOR THE BONDS - Debt Service Reserve Fund."

The obligations of the Borrower under the Loan Agreement are stated to be absolute and unconditional without right of set-off for any reason. Draws made under the Letter of Credit will be deemed to satisfy the obligations of the Borrower under the Loan Agreement to make payments of principal of and interest on the Bonds and to cover any Debt Service Reserve Fund Deficiency. The Letter of Credit does not cover any premium payable on the Bonds.

### **Assignment by Authority**

The Authority assigned all of its rights, title and interest in the Loan Agreement (except for certain rights reserved under the Loan Agreement) and pledged and assigned to the Trustee any payments, receipts and revenues receivable by it (except as aforesaid) under or pursuant to the Loan Agreement and the income earned by the investment of funds held under the Trust Agreement, as security for payment of the principal of and premium, if any, and interest on the Bonds. Except as provided in the preceding sentence, the Authority will not sell, assign or otherwise dispose of

its interest in the Loan Agreement or the payments, receipts and revenues of the Authority derived under the Loan Agreement.

### **Construction of the Project**

The Borrower will cause the Project to be constructed and equipped substantially in accordance with the Plans and Specifications (as defined in the Loan Agreement) therefor with all reasonable dispatch. The Authority and the Borrower agree that the moneys in the Construction Fund shall be applied to the payment of the cost of the Project and otherwise as provided in the Trust Agreement. If the moneys in the Construction Fund available for the payment of the cost of the Project should not be sufficient to pay or cause to be paid the cost of the Project, the Borrower agrees to cause the Project to be completed and to pay that portion of the cost of the Project as may be in excess of the moneys available therefor in the Construction Fund. The Authority does not make any warranty, either express or implied, that the moneys which will be paid into the Construction Fund will be sufficient to pay the cost of the Project. The Borrower agrees that if, after exhaustion of the moneys in the Construction Fund, the Borrower should pay or cause to be paid any portion of the cost of the Project, it shall not be entitled to any reimbursement therefor from the Authority or from the Trustee, and it shall not be entitled to any abatement, diminution or postponement of the payments required to be made by the Borrower under the Loan Agreement.

### **Inspections; Reports**

The Borrower will allow the Authority, the Trustee and the Letter of Credit Issuer, through their respective officers, employees, consultants and other authorized representatives, to have access, during normal business hours and upon reasonable prior notice, to make an inspection of the Project and examine certain books and records of the Borrower for purposes of ascertaining whether the Borrower has complied with the agreements and obligations under the Loan Agreement.

### **Maintenance and Operation of the Project**

The Borrower will cause the Project to be operated at all times as an Industrial Facility (as defined in the Act) and to be maintained, preserved and kept in good repair, working order and condition and will from time to time cause to be made all reasonably necessary and proper repairs, replacements and renewals; provided, however, that the Borrower will have no obligation to cause to be maintained, preserved, repaired, replaced or renewed any element or unit of the Project, the maintenance, repair, replacement or renewal of which, in the opinion of the Borrower, becomes uneconomic to the Borrower because of damage or destruction or obsolescence, or change in economic or business conditions or change in government standards and regulations. The Borrower shall not permit, commit or suffer any waste of the whole or any major part of the Project and shall not use or permit the use of the Project, or any part thereof, for any unlawful purpose or permit any nuisance to exist thereon.

### **Covenants as to Existence, Disposition of Assets and Assignments**

The Borrower, so long as the Bonds are outstanding, will maintain its existence, will not dispose of all or substantially all of its assets and will not acquire, consolidate with or merge into another person; provided, however, that the Borrower may acquire, consolidate with or merge into another person, or transfer to another person all or substantially all of its assets and thereafter dissolve, if: (i) the Letter of Credit Issuer gives its prior written consent to the extent such consent is required under the Reimbursement Agreement; (ii) the successor or transferee is solvent and irrevocably and unconditionally assumes in writing all the obligations of the Borrower under the Loan Agreement; (iii) such consolidation, merger or transfer shall not cause an Event of Taxability; and (iv) immediately after such consolidation, merger or transfer neither the Borrower nor such successor or transferee (if other than the Borrower) shall be in default in the performance or observance of any duties, obligations or covenants under the Loan Agreement.

The Borrower may sell, lease or otherwise transfer or encumber the Project, as a whole or in part, or it may assign its interest in the Loan Agreement, in whole or in part, without the consent of the Authority or the Trustee, but subject to the consent of the Letter of Credit Issuer (which consent may be given or withheld in accordance with the terms of the Reimbursement Agreement), if it meets the following requirements:

(1) prior to the proposed sale, lease or other transfer of the Project, as a whole or substantially as a whole, the Trustee, the Authority, and the Letter of Credit Issuer are provided with proof satisfactory to them by the Borrower (which may include an opinion from counsel knowledgeable in Federal and Commonwealth tax matters approved by the Trustee) that, as a result of such transfer or assignment or the terms thereof, interest payable on the Bonds would constitute Puerto Rico source income under the Code as in effect on the date of issuance of the Bonds;

(2) the Borrower shall within ten days after such sale, lease, transfer or encumbrance of the Project, or such assignment of the Loan Agreement, notify the Authority, the Trustee and the Letter of Credit Issuer thereof;

(3) the assignee shall, in a certificate delivered to the Authority, the Trustee and the Letter of Credit Issuer, which certificate shall be in a form reasonably satisfactory to the Authority, the Trustee and the Letter of Credit Issuer, expressly assume, and agree to pay and to perform, all of the obligations of the Borrower under the Loan Agreement that shall have been assigned to it; and

(4) the assignee shall deliver to the Authority, the Trustee and the Letter of Credit Issuer a certificate executed by its chief financial officer (or other executive officer performing similar functions) stating that none of the obligations, covenants and performances under the Loan Agreement and the Reimbursement Agreement assumed by it will conflict with or constitute on the part of such assignee a breach of, or default under, any indenture, mortgage, agreement or other instrument to which such assignee is a party or by which it is bound, or under any existing law, rule, regulation, judgment, order or decree to which such assignee is subject.

Notwithstanding any of the foregoing, no sale, lease or other transfer or encumbrance of the Project or assignment of the Loan Agreement shall: (i) relieve the Borrower of the obligation to make the payments required by the Loan Agreement, unless the Borrower obtains the prior written consent of the Authority, the Trustee and the Letter of Credit Issuer; (ii) relieve the Letter of Credit Issuer from its obligations under the Letter of Credit; or (iii) affect in any way the validity or enforceability of the Letter of Credit or any of the Security Agreements.

### **Maintenance of Source of Income**

In the Loan Agreement, the Borrower covenants that during each taxable year when the Bonds are outstanding it will conduct its business so that at all times all interest paid or payable on the Bonds will constitute income from sources within Puerto Rico under the general sourcing rules of the Code as in effect on the date of issuance of the Bonds. The Borrower is required to provide evidence annually in the form of an independent accountant certificate of whether it has complied with this covenant. If at any time such certificate shall show that interest paid or payable on the Bonds has ceased to constitute income from sources within Puerto Rico under the general sourcing rules of the Code as in effect on the date of issuance of the Bonds, and such interest would not otherwise be exempt from U.S. income tax when received by a Qualifying Bondholder, an "Event of Taxability" shall be deemed to have occurred and the Trustee shall send written notice to each person who is a Bondholder or who was a Bondholder during the preceding taxable year within five (5) business days of the receipt of such certificate or a Borrower's certificate stating that an Event of Taxability has occurred. A "Qualifying Bondholder" is: (i) an individual who during the entire taxable year with respect to which an Event of Taxability occurred was a bona fide resident of Puerto Rico; or (ii) a Puerto Rico corporation or other foreign corporation (for purposes of the Code) that is not engaged in any trade or business in the United States.

### **Indemnity**

Under the Loan Agreement, the Borrower will agree to indemnify the Authority and the Trustee against certain claims or liabilities arising from the construction and operation of the Project or its participation in the financing of the Project and certain other liabilities, and will agree to pay the fees and expenses of the Authority and the Trustee.

### **Limitation on Partners' Liability**

The partners and affiliates of the Borrower are not liable with respect to the payment of principal of , premium, if any, and interest on the Bonds.

## Events of Default and Remedies

Each of the following is an event of default under the Loan Agreement:

(1) failure by the Borrower to pay the principal of and premium, if any, or interest on the Bonds when the same shall become due and payable;

(2) failure by the Borrower to replenish the Debt Service Reserve Fund within one (1) Business Day from the date of the existence of a Debt Service Reserve Fund Deficiency; provided, however, that if such Debt Service Reserve Fund Deficiency arises solely as a result of a decline in the market value of the investments held to the credit of the Debt Service Reserve Fund, the Borrower shall have three (3) Business Days after receipt of notice of such deficiency from the Trustee to replenish the Debt Service Reserve Fund;

(3) failure by the Borrower to make other payments (excluding the payments under (1) and (2) above) required by the Loan Agreement if such failure shall continue for a period of thirty (30) days after written notice thereof is given to the Borrower by the Authority or the Trustee, unless a written extension is granted by the Authority or the Trustee prior to its expiration;

(4) failure by the Borrower to comply in any material respect, with certain covenants related to the maintenance of the corporate existence of the Borrower and the disposition of all or substantially all of their assets;

(5) failure by the Borrower to observe or perform certain other covenants, conditions or agreements under the Loan Agreement or under the Security Agreements (except the covenant to maintain insurance on the Project contained in the Security Agreements), other than those covered under (1), (2), (3) or (4) above, and continuation of such failure for thirty (30) days after written notice thereof, unless a written extension thereof is granted by the Authority and the Trustee prior to its expiration; provided, however, that if such failure cannot be corrected within such thirty-day period, it will not constitute an event of default if corrective action is commenced by the Borrower during such period and diligently and continuously pursued until such failure is corrected;

(6) certain events of bankruptcy, liquidation or similar proceedings involving the Borrower or the Letter of Credit Issuer; or

(7) (i) the Letter of Credit Issuer shall fail to honor a draft under the Letter of Credit complying with the terms thereof; or (ii) the Trustee shall have received from the Letter of Credit Issuer a notice to the effect that an event of default has occurred and is continuing under the Reimbursement Agreement or a notice that the interest portion of the Letter of Credit will not be reinstated after a draw on such Letter of Credit, in each case accompanied by instructions in writing from the Letter of Credit Issuer to accelerate the Bonds and sufficient funds from the Letter of Credit Issuer to pay the principal of and any interest on the Bonds; (iii) the Letter of Credit shall for any reason cease to be in full force and effect, or shall be declared to be null and void in whole or in part, or the validity or enforceability thereof shall be contested by the Letter of Credit Issuer, or the Letter of Credit Issuer shall renounce the same or deny that it has any further liability thereunder.

If by reason of Force Majeure (as defined in the Loan Agreement), the Borrower is unable to perform any of its obligations under (5) above, the Borrower will not be deemed to be in default during the continuance of such inability, including a reasonable time for the removal of the effect thereof.

The Authority has no power to waive any default under the Loan Agreement or extend the time for the correction of any default which could become an event of default without the consent of the Trustee and the Letter of Credit Issuer.

Upon the occurrence of an event of default, subject to the provisions of the Trust Agreement, the Trustee, as assignee of the Authority's rights, may declare all unpaid amounts payable under the Loan Agreement in respect of the Bonds to be immediately due and payable and may take any action at law or equity necessary to enforce any obligation

of the Borrower under the Loan Agreement or Security Agreements and of the Letter of Credit Issuer under the Letter of Credit.

### **Successor Letter of Credit**

The Loan Agreement provides that at any time on or prior to the sixtieth (60th) day preceding the expiration date of the then existing Letter of Credit, the Borrower may, at its option, provide for the delivery to the Trustee of a successor letter of credit (the "Successor Letter of Credit") issued by any financial institution or by an instrumentality of Puerto Rico (the "Successor Letter of Credit Issuer"). The Trustee will accept the Successor Letter of Credit if it shall have received:

- (1) An executed copy of the Reimbursement Agreement in relation to the Successor Letter of Credit;
- (2) An opinion of counsel to the Borrower, acceptable to the Authority and the Trustee to the effect that:  
(i) acceptance by the Trustee of the Successor Letter of Credit will not require registration of the Bonds, the obligations of the Borrower under the Loan Agreement or the Successor Letter of Credit under the Securities Act of 1933, as amended, or the Puerto Rico Uniform Securities Act, as amended, nor the qualification of the Trust Agreement under the Trust Indenture Act of 1939; or (ii) any registration statement required to be filed thereunder with respect to the Bonds, the Borrower's obligations under the Loan Agreement or the Successor Letter of Credit is effective, and the Trust Agreement has been duly qualified under such Trust Indenture Act;
- (3) An opinion of counsel to the Successor Letter of Credit Issuer to the effect that the Successor Letter of Credit is a legal, valid and binding obligation of the issuer thereof (subject to customary bankruptcy, creditor's rights and general principles of equity exceptions);
- (4) Written confirmation from S&P to the effect that the delivery of such Successor Letter of Credit will not cause the then current rating on the Bonds to be lowered by S&P; provided, however, that upon delivery of any such Successor Letter of Credit, the Bonds must be rated not lower than "A-" by S&P (or any equivalent rating then used by S&P), unless such Successor Letter of Credit is to be issued by an instrumentality of Puerto Rico in which case the Bonds may not be rated lower than "BBB" by S&P (or any equivalent rating then used by S&P);
- (5) A representation from the Successor Letter of Credit Issuer or an opinion from its legal counsel to the effect that the Successor Letter of Credit Issuer and the Borrower, as to each other, are not insiders or affiliates, as those terms are defined in the applicable statutory provisions of the United States Bankruptcy Code, as amended;
- (6) An opinion of counsel to the Authority to the effect that: (i) all documents and opinions required to be delivered to the Trustee in connection with the delivery of the Successor Letter of Credit on their face comply with the Loan Agreement and the Trust Agreement; and (ii) that the acceptance of the Successor Letter of Credit by the Trustee does not adversely affect the tax treatment of the Bonds; and
- (7) Such other documents and opinions as the Trustee may reasonably request.

Upon the fulfillment of such conditions, the Trustee shall return the Letter of Credit then in effect to its issuer.

Failure to provide for the delivery of a Successor Letter of Credit on or prior to the sixtieth (60th) day preceding the expiration of the then existing Successor Letter of Credit will result in a mandatory redemption of the Bonds. If on or prior to the sixtieth (60th) day preceding the expiration date of the then existing Letter of Credit (including any Successor Letter of Credit), the Letter of Credit has not been extended or a Successor Letter of Credit has not been obtained as described above, the Trust Agreement provides that the Trustee must draw under the Letter of Credit an amount sufficient, together with any Eligible Moneys on deposit in the funds maintained under the Trust Agreement, to redeem the Bonds in whole. See "THE BONDS - Mandatory Redemption."

## **Amendments**

The Loan Agreement may not be amended, changed, modified, altered or terminated, except in accordance with the terms of the Trust Agreement.

## **SUMMARY OF THE TRUST AGREEMENT**

The following briefly summarizes the material provisions of the Trust Agreement, as amended in connection with the issuance of the 2004 Bonds. This summary is not complete. You should read the more detailed provisions of the Trust Agreement for the provisions that may be important to you. A copy of the Trust Agreement may be obtained from the Borrower prior to the issuance of the 2004 Bonds and, thereafter, from the Trustee.

The Trust Agreement between the Authority and Banco Popular de Puerto Rico, as trustee, for the issuance of the 2000 Bonds was supplemented to provide for the issuance of the 2004 Bonds. Under the Trust Agreement, the Authority assigned to the Trustee for the benefit of the Bondholders all of the Authority's right, title and interest in the Loan Agreement (except for certain rights of the Authority under the Loan Agreement to indemnification, exemption from liability, notices and the payment of costs and expenses) in trust to provide for the payment of the principal of and premium, if any, and interest on the Bonds.

### **Construction Fund**

The proceeds from the sale of the 2004 Bonds, other than amounts to be deposited to the credit of the Debt Service Reserve Fund and the fee payable to the Authority and other charges and costs of issuance, will be deposited with the Trustee in the Construction Fund established under the Trust Agreement.

Payments of the costs of the construction, development and equipping of the Project will be made from the Construction Fund upon requisitions signed by the Borrower, authorized by the Letter of Credit Issuer, and presented to the Trustee.

### **Bond Fund**

There shall be deposited to the credit of the Bond Fund: (i) accrued interest, if any, on the Bonds paid by purchasers thereof; (ii) all amounts paid as repayment or optional or mandatory prepayment under the Loan Agreement; (iii) any amount in the Construction Fund and the Debt Service Reserve Fund to be transferred to the Bond Fund in accordance with the provisions of the Trust Agreement; (iv) amounts received under the Letter of Credit for the payment of the principal of or interest on the Bonds; (v) amounts representing the portion of the proceeds from the sale of the Bonds to be used by the Trustee to pay interest on the Bonds during the construction of the Project; (vi) all amounts derived by the Trustee for the benefit of the Bondholders from the Security Agreements to be utilized to pay principal of and interest on the Bonds; and (vii) all other moneys received by the Trustee under and pursuant to any of the provisions of the Loan Agreement or otherwise which are permitted or required or are accompanied by directions from the Borrower or the Authority that such moneys are to be paid into the Bond Fund. Notwithstanding the foregoing, any funds paid by the Borrower on any payment date and deposited into the Bond Fund for the payment of principal and interest on the Bonds which do not constitute Eligible Moneys shall be transferred to the Debt Service Reserve Fund.

### **Debt Service Reserve Fund**

On the date of issuance of the 2004 Bonds, the Borrower shall cause to be deposited from the proceeds of the 2004 Bonds to the credit of the Debt Service Reserve Fund the amount of \$365,550, equivalent to the maximum six months debt service on the 2004 Bonds. See "SOURCES OF PAYMENT AND SECURITY FOR THE BONDS - Debt Service Reserve Fund."

The Loan Agreement provides that to the extent any amounts are disbursed from the Debt Service Reserve Fund, the Borrower will be obligated to replenish the amounts so disbursed within one (1) Business Day after the occurrence

of any Debt Service Reserve Fund Deficiency. To the extent, however, that a Debt Service Reserve Fund Deficiency arises from a reduction in the market value of the Investment Obligations held in the Debt Service Reserve Fund, the Borrower will be obligated to replenish the Debt Service Reserve Fund within three (3) Business Days of receiving notice thereof.

### **Investment of Funds**

Money held for the credit of all funds and accounts under the Trust Agreement shall be invested in Investment Obligations in accordance with the instructions of the Borrower. Any such Investment Obligations shall mature not later than the respective dates when the money held for the credit of such funds or accounts will be required for the purposes intended.

Investment Obligations are defined in the Trust Agreement as Government Obligations and obligations of any agency or instrumentality whose obligations are backed by the full faith and credit of the United States of America and, to the extent from time to time permitted by law: (A) the obligations of: (i) Federal National Mortgage Association; (ii) Federal Home Loan Banks; (iii) Federal Farm Credit System; (iv) Federal Home Loan Mortgage Corporation; (v) Government National Mortgage Association; (vi) Federal Housing Administration; and (vii) Farmers Home Administration, provided, that any such obligations are rated in one of the four highest rating categories by S&P (without regard to any gradations within such categories); (B) repurchase agreements with financial institutions that are members of the Federal Reserve System or primary dealers in the United States Treasury market the short-term obligations of which institutions or dealers are rated at least "A-1" by S&P (or any equivalent rating to which it may be changed by S&P) or whose long-term obligations are rated in one of the four highest rating categories by S&P (without regard to any gradations within such categories) secured by any combination of investments or securities referred to in clause (A) provided, that the market value of the margin amount required on the trade/settlement date shall always be a minimum of 102% of the purchase price and not less than 100% of the repurchase price thereafter during the remaining tenure of the agreement, the Trustee shall be given a first priority security interest, no independent third party shall have a lien, such obligations purchased must be transferred to the Trustee or an independent third party agent by physical delivery or by an entry made on the records of the issuer of such obligations, in either case, the entity should receive confirmation from the independent third party that those securities are being held in a safe-keeping account in the name of the entity and such repurchase agreement shall constitute a "repurchase agreement" within the meaning of Section 101 of the United States Bankruptcy Code, as amended (the trust or safe-keeping departments of broker-dealers or financial institutions selling investments or pledging collateral or underlying securities, or their custodial agents, are not considered independent third parties for the foregoing purposes), and any investment in a repurchase agreement shall be considered to mature on the date the bank, trust company or recognized securities dealer providing the repurchase agreement is obligated to repurchase the Investment Obligations; (C) debt obligations and commercial paper rated at least "A-1" by S&P (or any similar rating to which it may be changed by S&P); (D) investment agreements in the form of interest bearing time deposits, repurchase agreements or similar arrangements rated, or guaranteed by a letter of credit or guaranty from a financial institution rated, within the four highest rating categories (without regard to gradations within such categories) by S&P in respect of money in the Debt Service Reserve Fund or the Construction Fund; (E) money market accounts of the Trustee or any state or federally chartered bank, banking association, trust company or subsidiary trust company that is rated or whose parent state bank is rated in one of the two highest short-term rating categories or in one of the four highest long-term rating categories by S&P (without regard to gradations within such categories); and (F) any other investment obligations rated by S&P in one of the four highest rating categories (without regard to any gradations within such categories) or otherwise approved in writing by S&P.

Government Obligations are defined in the Trust Agreement as: (i) direct obligations of, or obligations the timely payment of principal of and interest on which are fully and unconditionally guaranteed by, the United States of America; and (ii) any certificates or other evidences of ownership interest in obligations or in specified portions thereof (which may consist of specified portions of the principal thereof or the interest thereon) of the character described in clause (i), which certificates are rated in the highest rating category by S&P.

### **Events of Default**

Each of the following events is an event of default under the Trust Agreement:

(1) payment of the principal, premium, if any, or interest on the Bonds shall not be made when the same shall become due and payable;

(2) the Letter of Credit Issuer instructs the Trustee in writing to accelerate the Bonds as a result of the occurrence and continuance of an event of default under the Reimbursement Agreement or the nonreinstatement by the Letter of Credit Issuer of the interest portion of the Letter of Credit after a draw on such Letter of Credit; provided however, in each case, that the Letter of Credit Issuer deposits with the Trustee, prior to or concurrently with such instructions, funds sufficient, together with Eligible Monies deposited with the Trustee, to pay the principal of and interest on the Bonds then outstanding;

(3) (i) the Letter of Credit Issuer shall fail to honor a draft under the Letter of Credit complying with the terms thereof; or (ii) the Letter of Credit shall for any reason cease to be in full force and effect, or shall be declared to be null and void in whole or in part, or the validity or enforceability thereof shall be contested by the Letter of Credit Issuer, or the Letter of Credit Issuer shall renounce the same or deny that it has any further liability thereunder;

(4) the occurrence of certain events of bankruptcy, liquidation, insolvency or similar proceedings involving the Borrower or the Letter of Credit Issuer; or

(5) any event of default under the Loan Agreement (other than described in (1), (2), (3) or (4) above) shall have occurred and such event of default shall not have been remedied or waived.

#### **Acceleration of Maturities**

Upon: (i) the happening and continuance of an event of default specified in paragraph (2) above, the Trustee shall, and upon (ii) the happening and continuance of any other event of default specified above, the Trustee may, and upon the written request of Bondholders of not less than 25% in aggregate principal amount of Bonds then outstanding shall, but only after receiving the written consent of the Letter of Credit Issuer (except upon the occurrence and continuance of any of the events of default specified in (3) or (4) above, to the extent that it relates to the Letter of Credit Issuer), by notice in writing to the Authority and the Letter of Credit Issuer, declare the principal of all the Bonds then outstanding (if not due and payable) to be due and payable immediately, and upon such declaration the same shall become and be immediately due and payable.

If at any time after the principal of the Bonds shall have been declared to be due and payable, and before the entry of a final judgment or decree in any suit, action or proceeding instituted on account of such default, or before the completion of the enforcement of any other remedy under the Trust Agreement, Eligible Moneys shall have accumulated in the Bond Fund or the Debt Service Reserve Fund sufficient to pay the principal of all Bonds then outstanding (except the principal of any Bonds due and payable solely as a result of such acceleration) and the interest accrued on such Bonds since the last payment date to which interest shall have been paid or duly provided for, interest on overdue installments of interest (to the extent permitted by law) at the rate or rates then borne by the Bonds, and the charges, compensation, expenses, disbursements, advances and liabilities of the Trustee, and all other amounts then payable by the Authority under the Trust Agreement shall have been paid or a sum sufficient to pay the same shall have been deposited with the Trustee, and every other default known to the Trustee in the observance or performance of any covenant, condition, agreement or provision contained in the Bonds or in the Trust Agreement shall have been cured or waived, then and in every such case the Trustee may, and upon the written direction of the Bondholders of not less than a majority in aggregate principal amount of the Bonds then outstanding shall, by a notice in writing to the Authority, the Letter of Credit Issuer, the Borrower and S&P, rescind and annul such declaration and its consequences, but no such rescission or annulment shall extend to or affect any subsequent default or impair any right consequent thereon. Notwithstanding the foregoing, the Trustee shall not annul or waive any such declaration of acceleration unless the Letter of Credit Issuer confirms in writing to the Trustee that its Letter of Credit remains in full force and effect.

#### **Enforcement of Remedies**

Upon the happening and continuance of any event of default and the acceleration of the Bonds, then and in every such case the Trustee may, and upon the written direction of the Bondholders of not less 25% in aggregate principal



amount of the Bonds then outstanding under the Trust Agreement, shall, with the consent of the Letter of Credit Issuer (so long as the event of default shall not be of the type described in clauses (3) or (4) above, to the extent it relates to the Letter of Credit Issuer), proceed, subject to the provision of indemnification satisfactory to the Trustee, to protect and enforce its rights and the rights of the Bondholders under applicable laws, under the Loan Agreement, the Security Agreements and under the Trust Agreement by such suits, actions or special proceedings in equity or at law, as the Trustee, upon the advice of the counsel, shall deem most effective to protect such rights.

In the enforcement of any remedy under the Trust Agreement, the Trustee in its own name and as trustee of an express trust shall be entitled to sue for, enforce payment of and recover judgment for, any and all amounts then or after any default becoming, and at any time remaining, due from the Authority for principal, premium, if any, interest or otherwise under any of the provisions of the Trust Agreement or the Bonds and unpaid, with interest on overdue payments of principal, premium, if any, and interest (to the extent permitted by law) at the rate or rates of interest specified in the Bonds, together with any and all costs and expenses of collection and of all proceedings under the Trust Agreement and the Bonds, without prejudice to any other right or remedy of the Trustee or of the Bondholders, and to recover and enforce any judgment or decree against the Authority, but solely as provided in the Trust Agreement and in the Bonds, for any portion of such amounts remaining unpaid and interest, the costs and expenses as above provided, and to collect (but solely from moneys in the Bond Fund and any other moneys available for such purpose), in any manner provided by law, the moneys adjudged or decreed to be payable.

Subject to the provisions of the Trust Agreement described in the preceding two paragraphs, the Bondholders of a majority of the aggregate principal of Bonds then outstanding will have, subject to certain limitations, the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee. Except upon the occurrence of an Event of Taxability in the case of Qualifying Bondholders, no Bondholder will have any right to institute any suit, action or proceeding in equity or at law on any Bond or for the execution of any trust under the Trust Agreement, or for any other remedy under the Trust Agreement unless: (i) such Bondholder has previously given to the Trustee notice of the event of default on account of which such suit, action or proceeding is to be instituted; (ii) the Bondholders of not less than 25% of the aggregate principal of Bonds then outstanding have requested of the Trustee, after the right to exercise such powers or right of action, as the case may be, has accrued, and have afforded the Trustee a reasonable opportunity, either to proceed to exercise such powers or to institute such action, suit or proceeding in its or their name; (iii) the Trustee has been offered reasonable security and indemnity against the costs, expenses and liabilities to be incurred (including without limitation, indemnification for environmental liability); and (iv) the Trustee has refused or neglected to comply with such request within a reasonable time. Such notification, request and offer of indemnity are declared in every such case, at the option of the Trustee, to be a condition precedent to the execution of the powers and trust of the Trust Agreement or to any other remedy thereunder. No one or more Bondholders will have any right, in any manner, to affect, disturb or prejudice any rights under the Trust Agreement, or to enforce any right thereunder, except in the manner therein provided. All suits, actions and proceedings at law or in equity must be instituted, had and maintained in the manner provided in the Trust Agreement and for the benefit of the Bondholders. Any individual right of action or other right given to one or more Bondholders by law is restricted by the Trust Agreement to the rights and remedies therein provided. Nothing in the Trust Agreement shall impair the right of a Bondholder to enforce the payment of the principal amount, of premium, if any, and interest on any Bond.

### **Supplemental Trust Agreements**

The Trust Agreement may be amended or supplemented without the consent of the Bondholders: (a) to cure any ambiguity or formal defect or omission or to make any other changes with respect to matters or questions arising under the Trust Agreement which shall not be inconsistent with the provisions of the Trust Agreement; or (b) to grant or confer upon the Trustee for the benefit of the Bondholders or the Letter of Credit Issuer any additional rights, remedies, powers, benefits, authority or security that may lawfully be so granted or conferred; or (c) to add to the covenants of the Authority for the benefit of the Bondholders or to surrender any right or power conferred upon the Authority under the Trust Agreement; or (d) to provide for the issuance of Additional Bonds in accordance with the Trust Agreement and to make such other changes as may be necessary to adjust the terms of the Trust Agreement to reflect the issuance of such Additional Bonds; or (e) to permit the qualification of the Trust Agreement under the Trust Indenture Act of 1939 or any similar Federal statute hereafter in effect or to permit the qualification of the Bonds for sale under the securities laws of any of the states of the United States, and to add to the Trust Agreement or any supplement or

amendment thereto such other terms, conditions and provisions as may be required by said Trust Indenture Act of 1939 or similar Federal statute; or (f) to permit the delivery to the Trustee of a Successor Letter of Credit.

Other than for purposes of the above paragraph, the Trust Agreement may be amended or supplemented also with the consent of the holders of a majority of the principal amount of the Bonds at the time outstanding; provided, however, without the consent of each Bondholder affected, any amendment to the Trust Agreement may not: (a) extend the time for the payment of the principal of and premium, if any, or the interest on any Bond; or (b) reduce the principal of any Bond or the redemption premium, if any, or the rate of interest or yield thereon; or (c) create any lien or security interest with respect to the Loan Agreement or the payments thereunder, other than the lien created by the Trust Agreement; or (d) give a preference or priority to any Bond or Bonds over any other Bond or Bonds; or (e) modify the Trust Agreement in any way which adversely affects the rights of the Bondholders under the Letter of Credit or the rights of the Bondholders with respect to the real and personal property (other than reserves required by the Letter of Credit Issuer exclusively for its benefit under the Reimbursement Agreement) under the Security Agreements (it being understood that any such amendment or supplement may terminate or modify the rights of the Bondholders to any such reserves); or (f) reduce the aggregate principal of the Bonds required for consent to such supplement or amendment or any waiver thereunder.

The Trustee is not obligated to execute any proposed supplement or amendment if its rights, obligations and interests would be affected thereby. Nothing herein will affect any preexisting rights to create liens set forth in the Trust Agreement.

No amendment or supplement to the Trust Agreement will become effective without the written consent of the Borrower and the Letter of Credit Issuer.

#### **Amendments and Supplements to the Loan Agreement and the Security Agreements**

The Loan Agreement and the Security Agreements may be amended or supplemented without the consent of the Bondholders: (a) to make changes in the description of, or identify more precisely the Project; (b) to cure any ambiguity or formal defect or omission therein or, in any supplement thereto; (c) to grant to or confer upon the Authority or the Trustee for the benefit of the Bondholders any additional rights, remedies, powers, benefits, authority or security that may lawfully be granted to or conferred upon the Authority, the Trustee or the Bondholders; (d) to add to the covenants of the Borrower or in the case of the Letter of Credit, the Letter of Credit Issuer, for the benefit of the Bondholders or to surrender any right or power therein conferred upon the Borrower or the Letter of Credit Issuer; (e) in connection with any other change which, in the judgment of the Trustee, will not restrict, limit or reduce the obligation of the Borrower to make the payments under the Loan Agreement or to pay the principal of and premium, if any, and the interest on the Bonds or otherwise impair the security of the Bondholders under the Trust Agreement, provided such action will not materially adversely affect the interests of the Bondholders; or (f) to provide for the issuance of Additional Bonds in accordance with the Trust Agreement.

Other than for the purposes of the above paragraph, the Loan Agreement or the Security Agreements may be amended or supplemented with the approval of the Bondholders of not less than a majority of the principal of the Bonds at the time outstanding; provided, however, that the approval of the Authority, the Trustee or the Bondholders shall not be required to any proposed amendment to the Security Agreements (except for certain amendments to the Pledge Agreement and the Mortgage which may require said consent as provided in the Pledge Agreement) so long as the Letter of Credit Issuer is in compliance with its obligations under the Letter of Credit and the Letter of Credit Issuer shall have approved any such amendment or supplement.

#### **Defeasance**

Any Bond will be deemed paid and no longer entitled to any security under the Trust Agreement or the Letter of Credit upon satisfaction of certain conditions and the deposit with the Trustee of sufficient Eligible Moneys or Defeasance Obligations, which shall not contain provisions permitting the redemption thereof other than at the option of the holder, the principal of and the interest on which, when due (without any reinvestment thereof, will provide moneys which will be sufficient to pay when due the principal of and premium, if any, and interest due and to become due on

such Bond. Defeasance Obligations means: (i) noncallable Government Obligations; (ii) obligations of state, territory or local government issuers which are rated in the highest rating category by S&P, provision for the payment of the principal of and interest on which shall have been made by deposit with a trustee or escrow agent of noncallable Government Obligations, the maturing principal of and interest on such Government Obligations, when due and payable, shall provide sufficient money to pay the principal of and redemption premium, if any, and interest on such obligations of state, territory or local government issuers; (iii) obligations of Federal Home Loan Mortgage Corp., Farm Credit System, Federal Home Loan Banks, Federal National Mortgage Association, Student Loan Marketing Association, Financing Corp. and Resolution Funding Corp.; (iv) stripped debt securities where the principal-only and interest-only strips of noncallable obligations are issued by the U.S. Treasury; and (v) Resolution Funding Corp. securities stripped by the Federal Reserve Bank of New York. If any Bond is not to be redeemed or does not mature within sixty days after such deposit, the Borrower must give irrevocable instructions to the Trustee to give notice, in the same manner as notice of redemption, that such deposit has been made. The Bonds shall not be deemed paid unless the Trustee shall have received an opinion of counsel experienced in bankruptcy matters to the effect that payment to the Bondholders would not constitute a preference which may be avoided under the provisions of the United States Bankruptcy Code, an opinion of counsel experienced in tax matters under the Code to the effect that, assuming continuing compliance by the Borrower with the source of income covenants of the Loan Agreement, the deposit of said obligations or moneys would not adversely affect the interest received by the Bondholders as income from sources within the Commonwealth and all outstanding obligations under the Reimbursement Agreement shall have been paid in full.

## **SUMMARY OF THE REIMBURSEMENT AGREEMENT**

TDF has entered into a letter of credit and reimbursement agreement with the Borrower, amended as a result of the amendment to the TDF Letter of Credit to secure the 2004 Bonds (the "Reimbursement Agreement"), which provides that the Borrower will be obligated to reimburse TDF for any amounts funded pursuant to the TDF Letter of Credit and certain other matters. The following briefly summarizes the material provisions of the Reimbursement Agreement. This summary is not complete. You should read the more detailed provisions of the Reimbursement Agreement for the provisions that may be important to you. A copy of the Reimbursement Agreement may be obtained from the Borrower prior to the issuance of the 2004 Bonds and, thereafter, from the Trustee.

### **Operating Deficit Reserve Account**

Under the Reimbursement Agreement, the Borrower has deposited in Operating Deficit Reserves an aggregate amount equal to \$3,620,000 (the "Operating Reserves"). Moneys held to the credit of the Operating Reserves will be used for purposes of meeting the operating expenses of the Project whenever and to the extent other moneys available from the operation of the Project are not sufficient for such purposes. The Operating Reserves will not be held by the Trustee (in its capacity as trustee under the Trust Agreement) nor constitute security for the payment of the Bonds.

### **Events of Default**

It shall be deemed an event of default under the Reimbursement Agreement if any of the following events shall occur and be continuing, unless such event has been previously consented to in writing by TDF (capitalized terms used below and not otherwise defined herein shall have the meanings ascribed to them in the Reimbursement Agreement):

- (1) any amount payable by the Borrower under the Reimbursement Agreement shall not be paid when due; or
- (2) any representation, warranty or other statement made or deemed to have been made by the Borrower under or in connection with the Reimbursement Agreement, any of the other Operative Documents or any document, instrument or certificate executed or delivered in connection therewith shall prove to have been incorrect or misleading in any material respect when made or deemed to have been made; or
- (3) the Borrower shall fail to perform or observe any term, covenant or agreement contained in the Reimbursement Agreement or in any other Operative Documents or Project Document (in any such cases, other than as specifically addressed in other event of default provisions of the Reimbursement Agreement) and: (i) with respect to any

such term, covenant or agreement contained in the Reimbursement Agreement, any such failure shall remain unremedied for ten (10) days in the case of a default which can be cured by the payment of a sum of money and for thirty (30) days after notice, in the case of default which cannot be cured by payment of a sum of money; and (ii) with respect to any such term, covenant or agreement contained in the Reimbursement Agreement or in any of the other Operative Documents, any such failure shall remain unremedied after any applicable grace period specified in such documents; provided, however, that if such failure with respect to any term, covenant or agreement contained in the Reimbursement Agreement or any of the other Operative Documents is of a nature such that it cannot be cured by the payment of money and if such failure requires work to be performed, acts to be done or conditions to be removed which cannot by their nature, with due diligence, be performed, done or removed, as the case may be, within such thirty-day period or within the applicable grace period specified in the corresponding Operating Document, and such default is capable of cure by the Borrower, and the Borrower shall have commenced to cure such failure within such thirty-day period or within the applicable grace period specified in the corresponding Operating Document, such period shall be deemed extended for so long as shall be required by the Borrower, in the exercise of due diligence, to cure such failure; or

(4) the Borrower shall fail to perform or observe their covenants in connection with restrictions set forth in the Reimbursement Agreement pertaining to the sale or other transfer of the Project or any direct or indirect legal or equitable interest in the Borrower, including any interest in the partners of the Borrower or any interest therein (subject to certain exceptions) and the same shall not be cured or waived within ten (10) days after notice thereof; or

(5) there shall have been asserted in writing by or on behalf of the Borrower, the golf course operator, or the Construction Manager, that any material provision of the Reimbursement Agreement, the Management Agreement or the Construction Management Agreement, as the case may be, is not valid and binding on the Borrower, the golf course operator or the Construction Manager, as the case may be, or declaration shall have been sought by or on behalf of any of them that any such provision is null and void, or there shall have been commenced by or on behalf of any of them a proceeding to contest the validity or enforceability thereof, or there shall have been a denial by or on behalf of any of them that it has any further liability or obligation under the Reimbursement Agreement, the Management Agreement or the Construction Management Agreement, as the case may be; or

(6) the Borrower: (i) shall suffer or permit to be entered a decree or order a court or agency or supervisory authority having jurisdiction determining it to be insolvent or providing for the appointment of a conservator, receiver, liquidator, trustee or any similar person appointed in connection with any insolvency, readjustment of debt, marshaling of assets and liabilities, bankruptcy, reorganization or similar proceedings of or relating to it or of relating to all, or substantially all, of its property, or for the winding-up or liquidation of its affairs; or (ii) shall suffer or permit to be instituted against it proceedings under any law relating to bankruptcy, insolvency, or the reorganization or relief of debtors and such proceedings remain undismissed or pending and unstayed for a period of 120 days; or

(7) the Borrower shall: (i) consent to the appointment of a conservator, receiver, trustee, liquidator or custodian in any insolvency, readjustment of debt, marshaling of assets and liabilities or similar proceedings of or relating to it or relating to all, or substantially all, of its property or for the winding-up or liquidation of its affairs; (ii) admit in writing its inability to pay its debts generally as they become due; (iii) file a petition, or otherwise institute, or consent to the institution against it of proceedings to take advantage of any law relating to bankruptcy, insolvency or reorganization or the relief of debtors; (iv) make an assignment for the benefit of its creditors; or (v) suspend payment of its obligations; or

(8) the rendering of a final and unappealable judgment for the payment of money against the Borrower in excess of \$50,000 in the aggregate and the continuance of any such judgment unsatisfied and without stay of execution thereon for a period of 120 days after the entry of such judgment, or the continuance of such judgment unsatisfied for a period of 60 days after the termination of any stay of execution thereon entered within such first mentioned 120 days; or

(9) the Borrower's failure to cause Desarrolladora del Norte to execute and deliver to TDF, within sixty (60) days from August 20, 2004, the corresponding resolution evidencing the authority of the person executing the Deed of Subordination on Desarrolladora del Norte's behalf; or

(10) the exercise by Desarrolladora del Norte of the right of first refusal encumbering the land where the Project is located prior to the subordination in the registry of the property of such right of first refusal to the mortgage that secures the Additional Mortgage Note.

**Remedies of TDF**

If an event of default shall have occurred under the Reimbursement Agreement then, and in any such event at any time thereafter if such event of default is continuing, TDF may, in its discretion:

(1) by notice to the Borrower declare all amounts payable under the Reimbursement Agreement or under any other Operative Document to be immediately due and payable, whereupon the same shall become immediately due and payable without demand, presentment, protest or further notice of any kind, all of which are hereby expressly waived by the Borrower; and/or

(2) exercise all or any of its rights and remedies under or in respect of the Operative Documents, including, without limitation, its rights and remedies under the Security Documents and any indemnity; and/or

(3) by notice to the Trustee and the Authority, require the Trustee to accelerate payment of all Bonds and interest accrued thereon; and/or

(4) in the event that TDF or its designees or assignees undertake to complete the Project, TDF or its designees or assignees shall have the right to cause the proceeds of the Bonds to be disbursed on the same terms and conditions as if TDF or such designees and assignees of TDF were the Borrower; and/or

(5) exercise any or all other rights and remedies existing at law or in equity or by statute including, without limitation, the rights and remedies of a secured creditor under the laws of Puerto Rico.

In addition to any other rights and remedies TDF may have pursuant to the Operative Documents, or as provided by law, and without limitation thereof, if any default or event of default under the Reimbursement Agreement shall occur, then TDF shall not be obligated to instruct the Trustee to make any further disbursements while such default or event of default is remedied; provided, however, that TDF may instruct the Trustee to make any disbursement so long as any such default or event of default shall exist, without thereby waiving the right to demand payment of the indebtedness and to exercise its rights and remedies pursuant to the Reimbursement Agreement and/or any or more of the Operative Documents and/or exercise any other remedies available to TDF pursuant to any one or more of the Security Documents or as provided by law, and without becoming liable to instruct the Trustee to make any other or further advance or disbursement.

**Letter of Credit Fees**

Pursuant to the Reimbursement Agreement, the Borrower will be obligated to pay to TDF an annual fee equal to the applicable percentage set forth below based on the outstanding principal amount of the Bonds and interest on the Bonds for a period of one hundred and ninety-five (195) days, net of amounts in the Debt Service Reserve Fund, the Operating Reserves and other reserves created pursuant to the Reimbursement Agreement:

<u>Period</u>	<u>Percentage</u>
September 28, 2000 to September 19, 2007	1.50%*
September 20, 2007 to September 19, 2015	2.00%
September 20, 2015 to September 19, 2020	2.50%
September 20, 2020 to September 19, 2025	3.00%
September 20, 2025 to December 20, 2034	3.50%

\*Except that if in the years between September 20, 2005 and September 19, 2007 the debt service coverage is below 1.5x, the fee will be 2.00%.

Such fees will be payable in two semiannual installments on each interest payment date. The Borrower will also pay an up front fee of 0.25% of the principal amount of the 2004 Bonds, payable on the date of delivery of the 2004 Bonds.

## TAX MATTERS

In the opinion of Pietrantonio, Méndez & Alvarez LLP, Bond Counsel, the following discussion summarizes the material Puerto Rico and United States tax considerations relating to the purchase, ownership and disposition of the 2004 Bonds.

This discussion is based on the tax laws of Puerto Rico and the United States as in effect on the date of this official statement, as well as regulations, administrative pronouncements and judicial decisions available on or before such date and now in effect. All of the foregoing are subject to different interpretations and are also subject to change, which change could apply retroactively and could affect the continued validity of this summary. An opinion of counsel represents only such counsel's best legal judgment and is not binding on the Puerto Rico Treasury Department, any municipality or agency of Puerto Rico, the United States Internal Revenue Service or the courts. Accordingly, there can be no assurance that the opinions set forth herein, if challenged, would be sustained.

This discussion does not intend to describe all of the tax considerations that may be relevant to a particular investor in light of that person's particular circumstances and does not describe any tax consequences arising under the laws of any state, locality or taxing jurisdiction other than Puerto Rico and the United States.

**You should consult your own tax advisor as to the application to your particular situation of the tax considerations discussed below, as well as the application of any state, local, foreign or other tax.**

In the opinion of Bond Counsel, under the provisions of the Acts of Congress and the laws of Puerto Rico now in force:

1. Interest on, and gain on the disposition of, the 2004 Bonds is exempt from Puerto Rico income and withholding taxes, including the alternative minimum tax imposed by the Puerto Rico Internal Revenue Code of 1994, as amended (the "PR Code").

2. The 2004 Bonds are exempt from Puerto Rico property taxes imposed by the Municipal Property Tax Act of 1991, as amended, and the interest thereon is exempt from municipal license taxes imposed by the Municipal License Tax Act of 1974, as amended.

3. The 2004 Bonds are exempt from Puerto Rico gift tax with respect to donors who are residents of Puerto Rico at the time the gift is made and exempt from Puerto Rico estate tax with respect to estates of decedents who are residents of Puerto Rico at the time of death, except for United States citizens who did not acquire their United States citizenship solely by reason of birth or residence in Puerto Rico. Other individuals should consult their tax advisors with respect to the precise determination of the estate and gift tax consequences arising from a transfer of the 2004 Bonds by inheritance or gift.

4. The 2004 Bonds will be considered an obligation of an instrumentality of Puerto Rico for purposes of: (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the PR Code applicable to certain involuntary conversions; and (ii) the exemption from the surtax imposed by Section 1102 of the PR Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of Puerto Rico and certain other investments.

5. Interest on the 2004 Bonds constitutes "industrial development income" under Section 2(j) of the Puerto Rico Industrial Incentives Act of 1963, the Puerto Rico Industrial Incentives Act of 1978, the Puerto Rico Tax Incentives Act of 1987, and the Puerto Rico Tax Incentives Act of 1998, as amended (collectively, the "Acts"), when received by a holder of a grant of tax exemption issued under any of the Acts that acquired the 2004 Bonds with "eligible funds", as such term is defined in the Acts.

The PR Code does not provide rules with respect to the treatment of the excess of the amount due at maturity of a 2004 Bond over its initial offering price (“original issue discount”). Under current administrative practice followed by the Puerto Rico Department of the Treasury, original issue discount is treated as interest. Prospective owners of the 2004 Bonds, including but not limited to financial institutions, should be aware that ownership of the 2004 Bonds may result in having a portion of their interest expense allocable to interest or original issue discount on the 2004 Bonds disallowed for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

In the opinion of Bond Counsel, based upon the provisions of the Code now in force:

1. Interest on the 2004 Bonds is not excludable from the gross income of the recipients thereof for federal income tax purposes under Section 103(a) of the Code.

2. If (i) the Borrower is engaged in trade or business only in Puerto Rico during each taxable year when interest on the 2004 Bonds is paid or payable; (ii) such interest is not treated as paid by a trade or business conducted by the Borrower outside Puerto Rico, such determination to be made under Section 884(f)(1)(A) of the Code and the regulations thereunder; and (iii) for the three-year period ending with the close of the Borrower’s taxable year immediately preceding the payment of interest on the 2004 Bonds the Borrower either (a) derived more than 20% of its gross income from sources within Puerto Rico, or (b) derived more than 20% of its gross income from the conduct of a trade or business in Puerto Rico, both determinations to be made under Section 861(c)(1)(B) of the Code, then (a) in the case of an individual who is a *bona fide* resident of Puerto Rico during an entire taxable year, interest on the 2004 Bonds received by, or “original issue discount” (within the meaning of the Code and hereafter referred to as “OID”) on the 2004 Bonds otherwise required to be recognized as gross income and accrued to, such individual during such taxable year, will constitute gross income from sources within Puerto Rico and therefore, is excludable from gross income for purposes of the Code pursuant to Section 933(1) thereof, and (b) interest on the 2004 Bonds derived by, or OID on the 2004 Bonds otherwise required to be recognized as gross income and accrued to, a corporation organized under the laws of Puerto Rico or any other foreign country, as determined for purposes of the Code (“foreign corporations”), is not subject to taxation under the Code, provided that (x) such foreign corporation is not a foreign personal holding company, a controlled foreign corporation or a passive foreign investment company under the Code, (y) such foreign corporation is not treated as a domestic corporation for purposes of the Code and (z) interest on the 2004 Bonds and OID is not effectively connected with the conduct of a trade or business in the United States by such foreign corporation.

United States taxpayers, other than individuals who are *bona fide* residents of Puerto Rico during the entire taxable year, may be subject to federal income tax on any gain realized upon the sale or exchange of the 2004 Bonds. Pursuant to Notice 89-40, issued by the United States Internal Revenue Service on March 27, 1989, gain from the sale or exchange of the 2004 Bonds (excluding OID accrued under the Code as of the date of such sale or exchange) by an individual who is a *bona fide* resident of Puerto Rico during the entire taxable year and that is a resident of Puerto Rico for purposes of Section 865(g)(1) of the Code will constitute Puerto Rico source income and, therefore, qualify for the exclusion provided in Section 933(1) of the Code, provided such 2004 Bonds do not constitute inventory in the hands of such individual.

A portion of the interest expense incurred by an owner of the 2004 Bonds and allocable to interest received on the 2004 Bonds may be disallowed as a deduction for purposes of computing the regular tax and the alternative minimum tax under the PR Code.

The opinion of Bond Counsel regarding the tax consequences under the Code and the PR Code arising from ownership or disposition of the 2004 Bonds is limited to the above.

## LEGAL INVESTMENT

The 2004 Bonds will be eligible for deposit by banks in the Commonwealth to secure public funds and will be approved investments for insurance companies to qualify them to do business in the Commonwealth as required by law.

## **RATING**

The 2004 Bonds are rated “BBB” by S&P with the understanding that, upon delivery of the 2004 Bonds, the TDF Letter of Credit will be executed and delivered by TDF. The rating reflects only the views of such organization and an explanation of the significance of such rating may be obtained from Standard & Poor’s Rating Services, 25 Broadway, New York, New York 10004, telephone number (212) 438-2400.

There is no assurance that the rating will continue for any given period of time or that it will not be revised downward or withdrawn entirely by S&P, if in the judgment of such rating agency, circumstances so warrant. The Authority does not undertake any responsibility either to bring to the attention of the Bondholders the downward revision or withdrawal of any rating obtained or to oppose any such revision or withdrawal. Any such downward revision or withdrawal of such rating may have an adverse effect on the market price of the 2004 Bonds.

## **PLAN OF DISTRIBUTION**

Subject to the terms and conditions of a contract of purchase among the Authority, the Borrower and Santander Securities Corporation (the “Contract of Purchase”), the Authority has agreed to sell to Santander Securities Corporation (the “Purchaser”), and the Purchaser has agreed to purchase from the Authority, the aggregate principal amount of the 2004 Bonds.

The Purchaser will purchase the 2004 Bonds at an aggregate discount of \$56,233.94 from the initial public offering price of the 2004 Bonds set forth on the cover page hereof.

The 2004 Bonds are a new issue of securities with no established trading market. The Purchaser is not obligated to make a market in the 2004 Bonds and any such market making may be discontinued at any time at the sole discretion of the Purchaser. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the 2004 Bonds.

The Contract of Purchase will provide that certain obligations of the Purchaser thereunder are subject to approval of certain legal matters by counsel and to various other conditions. Under the terms of the Contract of Purchase, the Purchaser is committed to purchase all of the 2004 Bonds if any are purchased.

The Borrower has agreed to reimburse the Purchaser for its out of pocket expenses (including fees of their counsel) in connection with the sale of the 2004 Bonds. The Borrower has agreed to indemnify the Purchaser and the Authority against certain civil liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments that the Purchaser and the Authority may be required to make in respect thereof. The Borrower has also agreed to indemnify the Purchaser, the Authority and TDF against any liabilities or expenses that may arise out of their participation in the issuance of the 2004 Bonds.

The Purchaser has from time to time engaged in transactions with, or performed services for, GDB and TDF in the ordinary course of business. The Purchaser may continue to do so in the future.

Oriental Financial Services Corp. (“OFS”) has acted as placement agent for the Borrower in connection with the placement of the 2004 Bonds. In connection therewith, OFS will receive \$42,185.

## **LEGAL MATTERS**

Legal matters incident to the authorization, issuance and sale by the Authority of the 2004 Bonds and with regard to the tax-exempt status thereof are subject to the approving opinion of Pietrantonio Méndez & Alvarez LLP, San Juan, Puerto Rico, Bond Counsel. Legal matters incidental to the TDF Letter of Credit will be passed upon by O’Neill & Borges, San Juan, Puerto Rico. Certain legal matters will be passed upon for the Borrower by McConnell Valdés, San



Juan, Puerto Rico. McConnell Valdes Consulting, Inc., an affiliate of McConnell Valdes, has advised the Borrower in certain financial matters related to the Project.

### **CONTINUING DISCLOSURE COVENANT**

The Borrower and TDF have entered into a Continuing Disclosure Agreement (as such agreement is amended to reflect the issuance of the 2004 Bonds) with the Trustee wherein the Borrower and TDF covenanted for the benefit of the Bondholders and the Beneficial Owners of the Bonds to file within 120 days, in the case of the Borrower, and within 305 days, in the case of TDF, after the end of each of their respective fiscal years, with each nationally recognized municipal securities information repository (“NRMSIR”) and with any Commonwealth state information depository (“SID”), core financial information and operating data for such fiscal year, including: (i) audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time; and (ii) operating data and data relating to its revenues, expenditures, financial operations and indebtedness of the type generally found in this official statement.

The Borrower will covenant also to file in a timely manner, with each NRMSIR or with the Municipal Securities Rulemaking Board (“MSRB”), and with any Puerto Rico SID, notice of any of the following events with respect to the Bonds, if material:

- (a) principal and interest payment delinquencies;
- (b) non-payment related defaults;
- (c) unscheduled draws on debt service reserves reflecting financial difficulties;
- (d) unscheduled draws on credit enhancements reflecting financial difficulties;
- (e) substitution of credit or liquidity providers, or their failure to perform;
- (f) adverse tax opinions or events affecting the tax-exempt status of the Bonds, including the occurrence of an Event of Taxability;
- (g) modifications to rights of Bondholders;
- (h) bond calls;
- (i) defeasances;
- (j) release, substitution, or sale of property securing repayment of the Bonds; and
- (k) rating changes.

The Borrower and TDF will also covenant to file in a timely manner with each NRMSIR and with any Puerto Rico SID, notice of a failure by the Borrower or TDF, respectively, to provide the required annual financial information on or before the specified period.

These covenants were made in order to assist the Underwriters of the issuance of the 2000 Bonds, in complying with paragraph (b)(5) of Rule 15c2-12 (the “Rule”) of the Securities and Exchange Commission (the “SEC”).

Neither the Borrower or TDF undertake to provide the above-described event notice of a scheduled redemption, not otherwise contingent upon the occurrence of an event, if the terms, dates and amounts of redemption are set forth in detail in this official statement under “THE BONDS - Mandatory Redemption.”

The Borrower and TDF expect to provide the core financial information and operating data described above by delivering their respective audited financial statements prepared in accordance with generally accepted accounting principles for the applicable fiscal year and a supplemental report containing other information to the extent necessary to provide the core financial information and operating data described above by such deadline.

TDF entered into similar continuing disclosure agreements in connection with the issuance of other bonds guaranteed or supported by letters of credit issued by TDF. Due to an inadvertent omission, TDF did not file its financial statements for the fiscal years ended June 30, 1996, 1997, 1998 or 1999 with the NRMSIRs prior to the due date for such filings. TDF has now filed all such financial statements and has put in place a mechanism that it believes will facilitate compliance with its continuing disclosure obligations in the future.

As of the date hereof, there was no Commonwealth SID, and the nationally recognized municipal securities information repositories are: Bloomberg Municipal Repository, P.O. Box 840, Princeton, New Jersey 08542-0840; Kenny Information Systems, Inc., Attn.: Kenny Repository Service, 65 Broadway, New York, New York 10006; Thompson NRMSIR, 395 Hudson Street, New York, New York 10004, Attn: Municipal Disclosure; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

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

The Borrower and TDF acknowledge that their undertakings pursuant to the Rule described above are intended to be for the benefit of the Bondholders, and shall be enforceable by any such Bondholders; provided that the right to enforce the provisions of their respective undertakings shall be limited to a right to obtain specific enforcement of their obligations hereunder. Failure by the Borrower or TDF to comply with the undertakings will not constitute an event of default under the Loan Agreement, the Trust Agreement or the Bonds. Failure by the Borrower or TDF to comply with the undertakings must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the Bonds in the secondary market. Consequently, any such failure may adversely affect the transferability and liquidity of the Bonds and their market prices.

No Bondholder may institute any suit, action or proceeding at law or in equity (“Proceeding”) for the enforcement of the foregoing covenants or for any remedy for breach thereof, unless such Bondholder shall have filed with the Borrower or TDF written notice of a request to cure such breach, and the Borrower or TDF shall have refused to comply within a reasonable time. All Proceedings shall be instituted only as specified in such Continuing Disclosure Agreement in any Federal or Commonwealth court located in the Municipality of San Juan, and for the equal benefit of all Bondholders of the outstanding Bonds benefitted by the same or a substantially similar covenant, and no remedy shall be sought or granted other than specific performance by the Borrower or TDF of the covenant at issue. Notwithstanding the foregoing, no challenge to the adequacy of the information provided in accordance with the filings mentioned above may be prosecuted by any Bondholder except in compliance with the remedial and enforcement provisions contained in the Trust Agreement.

The above covenants may only be amended or waived if:

- i. the amendment or waiver is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of the Borrower or TDF; the covenants, as amended, or the provision as waived, would have complied with the requirements of the Rule at the time of award of the Bonds, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interests of the Bondholders, as determined by parties unaffiliated with the Borrower or TDF, or
- ii. all or any part of the Rule, as interpreted by the staff of the SEC at the date of the adoption of such interpretation, ceases to be in effect for any reason, and the members of the Borrower elect that the above covenants shall be deemed amended accordingly.

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

## **MISCELLANEOUS**

There are appended to this official statement information concerning the Borrower, the Project, a table setting forth the Accreted Value of the 2004 Bonds until June 20, 2008 and the principal amortization of the 2004 Bonds from such date until maturity, the financial statements for the year ended June 30, 2003 of TDF, and the form of opinion of Pietrantoni Méndez & Alvarez LLP, Bond Counsel. The financial statements of TDF, contained in Appendix D, have been audited by KPMG LLP, independent auditors, as stated in their report appearing therein. The information set forth

in this official statement in Appendices A (including Appendix A-1 (Borrower's financial statements as of December 31, 2003 and 2002) ) and B and all other information herein relating to the Borrower and the Project were obtained from the Borrower. The Borrower has reviewed the information contained herein which relates to it and the Project and has approved the use of all such information in this official statement. While such information is believed to be reliable, the Authority does not make any representations or warranties whatsoever with respect to it, and has relied upon it. At the closing for the 2004 Bonds, the Borrower will certify that such information does not contain a misstatement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they are made, not misleading. The Borrower has agreed to indemnify the Authority against certain liabilities.

TDF has reviewed solely the information contained herein which relates to it and has approved the use of all such information in this official statement. While such information is believed to be reliable, the Authority does not make any representations or warranties whatsoever with respect to it, and has relied upon it.

The execution and delivery of this official statement by its Executive Director have been duly authorized by the Authority, and this official statement has been approved by the Borrower.

This official statement will be filed with each NRMSIR and with the repository established by the MSRB.

**PUERTO RICO INDUSTRIAL, TOURIST,  
EDUCATIONAL, MEDICAL AND  
ENVIRONMENTAL CONTROL  
FACILITIES FINANCING AUTHORITY**

By: \_\_\_\_\_  
Name:  
Title:

Approved:

**COCO BEACH GOLF & COUNTRY CLUB, S.E.**

By: Betterroads Asphalt Corporation,  
its Managing Partner

By: \_\_\_\_\_  
Name:  
Title:

## THE BORROWER

### General

Coco Beach Golf & Country Club, S.E. (the “Borrower”) is a partnership organized under the Puerto Rico Civil Code that has elected to be treated as a special partnership under Subchapter K of Chapter 3 of Subtitle A of the Puerto Rico Internal Revenue Code of 1994, as amended (the “Code”) and Act No. 3 of September 27, 1985, as amended. The Borrower was organized on December 30, 1999 for the purpose of building, developing and owning the Coco Beach Golf & Country Club, which is intended to consist of two 18-hole championship golf courses, a clubhouse and related facilities (the “Project”). The Borrower’s mailing address is P.O. Box 21420, Río Piedras, Puerto Rico 00928. The Borrower is governed by a Deed of Amended and Restated Partnership Agreement (the “Partnership Agreement”), that may be further amended or restated from time to time. The term of the Partnership Agreement will be in effect until December 31, 2099, unless previously terminated in accordance with its terms. Capitalized terms not otherwise defined herein will have the meanings assigned to them in the official statement.

Enclosed as Appendix A-1 are the audited financial statements of the Borrower as of December 31, 2003 and 2002.

### The Partners

#### *Betterroads Asphalt Corporation - Managing Partner*

Betterroads, a privately-held Puerto Rico corporation organized in 1954 by Mr. Arturo Díaz, Jr., is the largest asphalt producer and paving company in the Caribbean. Betterroads owns a network of plants in Puerto Rico that makes it self-sufficient in most areas of asphalt-mixing and paving. With fixed and portable plants and aggregate facilities, Betterroads’ crews are capable of working on a variety of projects, such as highways, airports and parking areas. Betterroads has worked on major paving projects in Puerto Rico, such as the Luis Muñoz Marín International Airport, the Plaza Las Americas Shopping Mall, in Hato Rey; and the Puerto Rico 2, Puerto Rico 3, Las Americas and De Diego Highways. Betterroads has also performed paving works in St. Marten, St. Thomas and the Dominican Republic.

The following persons are the directors and principal executive officers of Betterroads, each one of whom has been elected or appointed to serve until his successor is duly elected and qualified:

<u>Name</u>	<u>Position</u>
Arturo Díaz, Jr.	President and Chairman of the Board of Directors
Jorge Luis Díaz Irizarry	Treasurer and Director
Judith Irizarry Morales	Secretary and Director
Arturo Díaz Irizarry	Assistant Treasurer and Director
Arturo Ocasio Martínez	Director

Betterroads is the owner of all issued and outstanding shares of common stock of Coco Beach Development Corporation (“Coco Beach Development”) and CBM Investment Corporation (“CBM Investment”), both Puerto Rico corporations. Betterroads, Coco Beach Development and CBM Investment, have and will continue to participate, directly or indirectly, in the development of the 980-*cuerdas* Coco Beach Resort and Community Development where the Project is located.

### **PFPP Coco Beach L.P. - Partner**

PFPP Coco Beach L.P. is an affiliate of Willowbend. Based in Chestnut Hill, Massachusetts, Willowbend is a privately-held Massachusetts limited liability company that specializes in acting as owner, builder, developer, operator, construction manager and contractor of golf and hospitality-related resort facilities. Organized in 1991, Willowbend has majority interests in developments worth over \$350 million. Through its affiliated companies (Willowbend Land Design, Inc., Golf Realty Advisors, Willowbend Golf Construction LLC and Willowbend Golf Management LLC), Willowbend has been involved as broker, developer, principal or consultant in over 125 golf related real estate transactions during the past ten years. In Puerto Rico, Willowbend has been involved in the development and operation of the Westin Rio Mar Beach Resort and Country Club, a 600-room, four-star hotel and casino with two 18-holes championship golf courses and country club located in Río Grande, Puerto Rico and the Ocean Villas at Rio Mar. In 1997, Willowbend served as Golf Construction Manager of Dorado Del Mar Golf & Country Club in Dorado, Puerto Rico.

### ***Mr. Arturo Díaz, Jr. - Partner***

Mr. Díaz is the President, principal stockholder and founder of Betterroads. He was also the founder of Arturo Díaz Construction Corporation, San Juan Dredging, Best Contracting Corporation, San Juan Cement Company, Coco Beach Development and Betterrecycling Corporation. Through these and other companies, Mr. Díaz has played a prominent role in the development of major construction and infrastructure projects in Puerto Rico. Mr. Díaz was involved in the construction of the 65<sup>th</sup> Infantry Highway, the Baldorioty de Castro Expressway, the dredging of San Juan Bay, and the Trujillo Alto Expressway.

Mr. Díaz has served as President, Chairman and Director of several business and trade associations, including the Puerto Rico Manufacturers Association, the American Road Builders Association, and the Portland Cement Association for the Caribbean. He has also served as Chairman of the Board of Directors of the Puerto Rico Water Resources Authority, the Governor's Advisory Committee for Industrial Affairs, and the Advisory Committee to the Economic Development Administration of Puerto Rico.

### **Management and Control of the Borrower**

The decisions regarding the affairs of the Borrower are made by a vote of the majority of the ownership interests in the Borrower. Betterroads, as managing partner, is responsible for the day to day operations and overall management and control of the business and affairs of the Borrower. The management functions of Betterroads with respect to the Project include supervising the construction manager and the operator of the Project; arranging any debt financing for capital improvements or in connection with the purchase of assets related to the Project; executing any and all agreements, contracts, documents, certificates and instruments necessary or convenient in connection with the "the development, construction and financing of the Project; conducting physical inspections, marked surveys and continual reviews to determine if and when the Project should be sold; preparing economic surveys, projections of cash flow, taxable income or loss and working capital requirements; supervising and reviewing Borrower's bookkeeping, accounting, audits and tax returns; making all elections required to be made by the Borrower pursuant to the Code; and supervising professionals employed by the Borrower in connection with any of the foregoing, including attorneys, accountants and appraisers.



**COCO BEACH GOLF & COUNTRY CLUB, S.E.**  
(A Partnership in Development Stage)

Financial Statements

December 31, 2003 and 2002

(With Independent Auditors' Report Thereon)



KPMG LLP  
American International Plaza  
Suite 1100  
250 Muñoz Rivera Avenue  
San Juan, PR 00918-1819

## Independent Auditors' Report

The Partners  
Coco Beach Golf & Country Club, S.E.:

We have audited the accompanying balance sheets of Coco Beach Golf & Country Club, S.E. (the Partnership) (a partnership in development stage) as of December 31, 2003 and 2002, and the related statements of operations, partners' capital, and cash flows cumulative from the inception of the Partnership and for the years then ended. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Coco Beach Golf & Country Club, S.E. as of December 31, 2003 and 2002, and the results of its operations and its cash flows cumulative from the inception of the Partnership and for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

March 19, 2004

Stamp No. 1902133 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



**COCO BEACH GOLF & COUNTRY CLUB, S.E.**  
(A Partnership in Development Stage)

Balance Sheets

December 31, 2003 and 2002

Assets	<u>2003</u>	<u>2002</u>
Property and equipment:		
Project under development (notes 2, 3, 4, and 7)	\$ 37,601,603	21,919,501
Equipment, less accumulated depreciation of \$129,079 and \$11,816 in 2003 and 2002, respectively	<u>1,021,787</u>	<u>73,973</u>
Net property and equipment	38,623,390	21,993,474
Cash	5,593,686	43,516
Interest receivable	36,761	33,567
Interest-bearing deposits held in trust – restricted (note 7)	9,661,744	17,543,434
Debt issue costs, less accumulated amortization of \$78,402 and \$54,110 in 2003 and 2002, respectively (note 7)	784,051	808,343
Prepaid expenses	—	2,910
Land held on behalf of partner (note 5)	<u>632,335</u>	<u>632,335</u>
Total assets	<u>\$ 55,331,967</u>	<u>41,057,579</u>
<b>Liabilities and Partners' Capital</b>		
Accounts payable and other accruals (including retainages payable amounting to \$681,865 and \$172,047 in 2003 and 2002, respectively) (note 3)	\$ 2,259,388	901,380
Note payable to partner (note 6)	484,365	63,008
Due to partners and affiliates (including retainages payable amounting to \$397,315 and \$386,495 in 2003 and 2002, respectively)	8,016,751	662,614
Interest payable	38,734	38,734
Loan payable, net of discount of \$397,662 and \$409,983 in 2003 and 2002, respectively (note 7)	17,602,338	17,590,017
Land held on behalf of partner (note 5)	<u>632,335</u>	<u>632,335</u>
Total liabilities	29,033,911	19,888,088
Partners' capital (note 8):		
Partners' contribution	27,619,890	21,820,610
Cumulative net loss during development stage	<u>(1,321,834)</u>	<u>(651,119)</u>
Total partners' capital	26,298,056	21,169,491
Commitment and contingencies (notes 2, 3, and 7)		
Total liabilities and partners' capital	<u>\$ 55,331,967</u>	<u>41,057,579</u>

See accompanying notes to financial statements.



**COCO BEACH GOLF & COUNTRY CLUB, S.E.**  
(A Partnership in Development Stage)

Statements of Operations

Cumulative from the inception of the Partnership and  
years ended December 31, 2003 and 2002

	<b>Cumulative from the inception of the Partnership</b>	<b>2003</b>	<b>2002</b>
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Revenue:			
Interest income	\$ 530,021	—	34,323
Operating expenses:			
General and administrative	1,847,380	670,232	447,919
Interest expense, net of capitalized interest	<u>4,475</u>	<u>483</u>	<u>425</u>
	<u>1,851,855</u>	<u>670,715</u>	<u>448,344</u>
Net loss during development stage	\$ <u>(1,321,834)</u>	<u>(670,715)</u>	<u>(414,021)</u>

See accompanying notes to financial statements.

**COCO BEACH GOLF & COUNTRY CLUB, S.E.**  
(A Partnership in Development Stage)

**Statements of Partners' Capital**

Cumulative from the inception of the Partnership and  
years ended December 31, 2003 and 2002

	<u>Betterroads</u>	<u>Díaz</u>	<u>PFP</u>	<u>Total</u>
Partners' capital, December 31, 1999	\$ 900	100	—	1,000
Capital contributions	18,637,649	2,181,961	1,000,000	21,819,610
Accumulated net loss during development stage prior to December 31, 2001	<u>(196,792)</u>	<u>(23,710)</u>	<u>(16,596)</u>	<u>(237,098)</u>
Partners' capital, December 31, 2001	18,441,757	2,158,351	983,404	21,583,512
Net loss during development stage	<u>(343,638)</u>	<u>(41,402)</u>	<u>(28,981)</u>	<u>(414,021)</u>
Partners' capital, December 31, 2002	18,098,119	2,116,949	954,423	21,169,491
Capital contributions	4,813,415	579,929	405,936	5,799,280
Net loss during development stage	<u>(556,693)</u>	<u>(67,072)</u>	<u>(46,950)</u>	<u>(670,715)</u>
Partners' capital, December 31, 2003	\$ <u>22,354,841</u>	<u>2,629,806</u>	<u>1,313,409</u>	<u>26,298,056</u>

See accompanying notes to financial statements.

**COCO BEACH GOLF & COUNTRY CLUB, S.E.**  
(A Partnership in Development Stage)

Statements of Cash Flows

Cumulative from the inception of the Partnership and  
years ended December 31, 2003 and 2002

	Cumulative from the inception of the Partnership	2003	2002
<b>Cash flows from operating activities:</b>			
Net loss during development stage	\$ (1,321,834)	(670,715)	(414,021)
Adjustments to reconcile net loss during development stage to net cash provided by operating activities:			
Depreciation	129,079	117,263	11,816
Decrease in prepaid expenses	—	2,910	34,033
Increase in accounts payable and accruals	2,259,388	1,358,008	450,747
Increase in due to partners and affiliates	8,016,751	7,354,137	241,335
Increase (decrease) in interest payable	38,734	—	—
Net cash provided by operating activities	<u>9,122,118</u>	<u>8,161,603</u>	<u>323,910</u>
<b>Cash flows from investing activities:</b>			
Interest-bearing deposits held in trust, restricted (including related interest receivable)	(9,698,505)	7,878,496	4,944,772
Project under development	(28,083,433)	(15,645,489)	(5,096,306)
Acquisition of equipment	(1,150,866)	(1,065,077)	(47,533)
Net cash used in investing activities	<u>(38,932,804)</u>	<u>(8,832,070)</u>	<u>(199,067)</u>
<b>Cash flows from financing activities:</b>			
Debt issue costs	(862,453)	—	—
Proceeds from loan payable	17,562,570	—	—
Proceeds from note payable to partner	1,621,254	454,455	300,992
Principal payments on note payable to partner	(1,136,889)	(33,098)	(452,269)
Capital contributions	18,219,890	5,799,280	—
Net cash provided by (used in) financing activities	<u>35,404,372</u>	<u>6,220,637</u>	<u>(151,277)</u>
Increase (decrease) in cash	5,593,686	5,550,170	(26,434)
Cash, beginning of period	—	43,516	69,950
Cash, end of period	<u>\$ 5,593,686</u>	<u>5,593,686</u>	<u>43,516</u>
<b>Supplemental disclosure of cash flow information:</b>			
Interest paid, including capitalized interest	\$ 4,100,460	1,267,674	1,322,125
<b>Supplemental information of noncash items:</b>			
A parcel of land held on behalf of a partner was temporarily transferred to the Partnership during year 2000 (refer to note 5)	\$ 632,335	—	—
One of the partners contributed a parcel of land during 2000, which is included as part of the cost of the project under development	9,400,000	—	—
The Partnership has capitalized as project under development amortization of loan discounts and debt issue costs	118,170	36,613	36,606

See accompanying notes to financial statements.

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**(1) Organization and Summary of Significant Accounting Policies**

Coco Beach Golf & Country Club, S.E. (the Partnership) is a special partnership organized on December 30, 1999 under the laws of the Commonwealth of Puerto Rico to acquire, develop, construct, own, use, sell, lease, operate, and manage a country club consisting of golf courses, clubhouses, recreational amenities, and other tourism facilities. The Partnership is currently developing two 18-hole championship golf courses, a clubhouse, and related facilities in the municipality of Río Grande, Puerto Rico in a project known as Coco Beach Golf & Country Club (the Project). The Project is being developed next to a hotel resort currently also under development (the Hotel). The partners of the Partnership are Betterroads Asphalt Corporation (Betterroads or the Managing Partner), a corporation organized under the laws of the Commonwealth of Puerto Rico, Mr. Arturo Díaz, Jr., (Díaz) owner of Betterroads, and PFP Coco Beach, L.P. (PFP), a Delaware limited partnership.

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

**(a) Income Taxes**

The Partnership has elected special partnership status and operates under Subchapter K of the Puerto Rico Internal Revenue Code of 1994 (the Code), as amended. As a special partnership, the Partnership is not subject to income taxes, but rather, the income or loss of the Partnership is reportable by the partners in their tax returns, so long as the Partnership complies with certain provisions of Subchapter K.

Section 1330(b)(2)(A) of the Code provides that gross income generated by the special partnership from a qualifying activity will include income resulting from the temporary investment of the special partnership's funds for the period prior to the commencement of its qualifying activity, and that such period will not be more than 36 months.

Since the Partnership was organized on December 30, 1999, the 36-month period provided by the Code expired on December 29, 2002. As of such date, the Partnership had been unable to commence its qualifying activity because the construction of the golf course and the Hotel, Paradisus Puerto Rico Hotel, to which its golf operations are associated, had not been completed.

Management of the Partnership requested that the extension of time provided by the Code be granted to the Partnership and that the income generated by the temporary investment of the Partnership's funds constitute income generated by qualifying activities until the commencement of qualifying activities, in no case later than June 30, 2004, the expiration of the 18-month additional period. As mentioned in note 10, the Partnership commenced the operation of its qualifying activity on March 5, 2004. Accordingly, no provision for Puerto Rico income taxes has been made in the accompanying financial statements.

Management of the Partnership believes that it complied with all other provisions of Subchapter K.

**(b) Discounts and Debt Issue Costs**

Discounts on loan and debt issue costs related to the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (AFICA) loans payable have

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been deferred and are being amortized over the terms of the debt using a method which approximates the interest method. Amortization of discount and debt issue costs is capitalized as financing costs of a project under development.

**(c) Equipment**

Equipment consists of machinery used for the maintenance of the golf courses under development. Equipment is stated at cost and is depreciated using the straight-line method over the estimated useful lives of the assets. Other equipment not placed into use is included as part of the project under development.

**(d) Land Contribution**

Land contribution by a partner has been recorded at estimated fair value of \$9,400,000 based on independent appraisal.

**(e) Use of Estimates**

The management of the Partnership has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

**(f) Impairment of Long-Lived Assets**

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets.

In accordance with SFAS No. 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Although the Project is currently under development and thus future cash flows cannot be predicted with certainty, management has evaluated the estimated future cash flows of the Project after commencement of operations and does not currently expect the adoption of such statement to have a material effect on the financial position of the Partnership.

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**(g) *Reclassifications***

Certain reclassifications were made to the 2002 financial statements to conform them to the 2003 presentation.

**(2) *Capitalization of the Partnership***

On September 28, 2000, the Partnership closed its debt and equity financing to fund the Project costs. Financing was primarily provided through a loan agreement with AFICA for \$18,000,000 and the contribution by the partners of \$12,420,610 in cash and land valued at \$9,400,000. During 2003, the partners contributed capital amounting to \$5,799,280 to fund additional Project costs.

**(3) *Construction Management Agreement, Golf Architectural Agreement, Construction Contracts, Service Agreement, Club Management Agreement, Asset Management Agreement, and Use and Access Agreement***

**(a) *Construction Management Agreement***

The Partnership entered into a construction management agreement with PFP Golf Construction, L.P., S.E. (the Construction Manager), a related party to one of the partners, to oversee and manage the construction of the Project. The construction manager will assist the Partnership in creating an overall development plan for the Project, selecting consultants and other professionals, implementing plans and seeking approvals, coordinating consultants and construction management professionals, and will otherwise provide general development support and overall assistance to the Partnership on an ongoing basis until the construction is completed. The Partnership shall pay the construction manager a lump sum equal to 3.5% of the total Project cost based on the Project budget included in the agreement. An initial payment of \$75,000 was made upon the execution of this agreement. The remainder of the fee shall be paid in equal monthly installments, which shall be recalculated from time to time depending on the estimated completion date of the golf course portion of the work or the project buildings, whichever is later. During 2003, the monthly installments amounted to \$7,855 for three months and \$2,618 for nine months and during 2002, the monthly installments amounted to \$7,855. The Partnership will also reimburse the Construction Manager for any additional services and reimbursable expenses in accordance with the construction management agreement.

The Partnership has incurred \$445,300 and \$398,170 in construction management fees as of December 31, 2003 and 2002, respectively, which have been included in the accompanying financial statements as part of the costs of the project under development. The Partnership also reimbursed the development manager \$934,473 and \$694,778 of expenses incurred as of December 31, 2003 and 2002, respectively.

**(b) *Golf Architectural Agreement***

The Partnership entered into a golf architectural plan production agreement with Willowbend Development Corporation (the Golf Architect), a related party of the Construction Manager, for design and production of the architectural plans and the development plans of the Project's golf courses. Contract costs under this agreement will amount to \$440,000 of which \$429,240 and \$426,780 have been incurred as of December 31, 2003 and 2002, respectively. The Partnership will

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also reimburse the Golf Architect for reimbursable expenses in accordance with the architectural agreement which are expected to amount to approximately \$69,000. As of December 31, 2003 and 2002, the Partnership has incurred \$47,759 and \$44,827, respectively, related to reimbursable expenses in accordance with this agreement.

**(c) Construction Contracts**

The Partnership entered into a contract agreement with PFP Golf Construction L.P., S.E., for the golf course shaping labor of the Project. Contract costs under this agreement will amount to \$965,137, of which \$915,973 and \$589,601 have been incurred as of December 31, 2003 and 2002, respectively.

The Partnership and its Construction Manager also entered into a construction contract with Betterroads (the contractor) for the construction of the golf course facilities (excluding the clubhouse and related equipment). Contract costs under this agreement will amount to \$9,428,002, of which \$8,925,135 and \$3,581,427 have been incurred as of December 31, 2003 and 2002, respectively.

During 2002, the Partnership entered into a contract agreement with SAJO Golf to provide certain golf construction work for the Project. Contract costs under this agreement will amount to \$2,370,262, of which \$1,701,887 and \$957,263 have been incurred as of December 31, 2003 and 2002, respectively.

During 2003, the Partnership entered into two construction contracts with Bermudez & Longo. One of the contracts is for the construction of an irrigation system and electric line for the golf course facilities. The contract cost under this agreement which amounted to \$198,993 was all incurred as of December 31, 2003. The other contract is for the construction of a lighting system and telephone conduit system. The contract cost under this agreement will amount to \$204,000 of which \$94,720 has been incurred as of December 31, 2003.

On February 13, 2003, the Partnership entered into a construction contract agreement with Constructora Santiago II, Corp. for the construction of the clubhouse facilities. The contract costs under this agreement will amount to \$7,084,626, of which \$4,079,968 has been incurred as of December 31, 2003.

On December 12, 2003, the Partnership also entered into a construction contract with Ryam Construction Corporation for the construction of parking lot facilities. The contract costs under this agreement will amount to \$236,678, of which \$100,270 has been incurred as of December 31, 2003.

**(d) Service Agreement**

The Partnership entered into a service agreement with Betterroads for certain predevelopment and development services, including within others, the negotiation of certain agreements, applying for permits, and authorizations for the construction of the Project, arranging for an AFICA bond issuance (the AFICA services), receiving and approving all requisitions to be submitted by the Construction Manager and monitoring the Construction Manager's compliance with its obligations, and maintaining records of the Project. Services obtained under this agreement, except for the AFICA services, are collectively referred to as the development services. On the date of the issuance of the AFICA bonds, the Partnership paid \$150,000 as consideration for the AFICA services and a

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fee of \$50,000 as consideration for the development services. No commitment is outstanding under the service agreement except for reimbursement of expenses to be incurred by Betterroads in performing its obligation thereunder.

**(e) Club Management Agreement**

The Partnership entered into a club management agreement with PFP Golf Management L.P., S.E., a related party to one of the partners, to manage the Project's Golf and Country Club (the Club) as a first-class club, including the development, design, marketing, and administration of a membership program at the Club. The Partnership shall pay a management fee equal to 3.5% of the annual gross revenue (as defined in the agreement). In addition to the management fee the Partnership shall reimburse the club manager for costs incurred by the club manager in performing its obligation thereunder, which are approved and qualify as reimbursable expenses under the agreement.

The club manager is responsible under the club management agreement for setting aside 1% of the gross revenue during the first 12-month period following the commencement date, 2% of the gross revenue during the second 12-month period following the commencement date, and 3% of the gross revenue during each ensuing 12-month period thereafter, to establish a fund for the purpose of paying for capital improvements and furniture, fixtures, and equipment replacements to be made pursuant to this agreement. These funds shall be deposited monthly in an account used exclusively for such purpose (the Fund account) which shall be under the control of the Partnership.

**(f) Asset Management Agreement**

The Partnership entered into an asset management agreement with PFP Golf Management L.P., S.E. (the Asset Manager) for services in connection with the financing, development, and management of the Project. The contract will extend through the duration of the club management agreement. The fees under the asset agreement will amount to 1% of the total project budget, and subsequent to opening the Project, to 1% of gross revenue derived from the operation of the country club. However, such fees shall be waived so long as the construction management agreement and subsequently, the club management agreement, remain in full force and effect. The Partnership will also reimburse the Asset Manager for any costs incurred in performing its obligations thereunder. No fees nor costs have been incurred in relation to this contract during 2003 and 2002.

**(g) Use and Access Agreement**

The Partnership and its club manager entered into a use and access agreement with both the Hotel owner and Hotel manager in order to permit guests staying at the Hotel to have access to the club facilities and certain tee times for golf play and to permit members of the club and their guests to have access to the Hotel facilities in accordance with the terms of the agreement.



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**(4) Project Under Development**

Project under development is summarized as follows:

	2003	2002
Land	\$ 9,442,329	9,442,329
Equipment	445,260	—
Construction in progress	17,992,255	8,558,749
Development and other costs	7,845,581	3,212,439
Capitalized interest and financing costs	1,876,178	705,984
	\$ 37,601,603	21,919,501

**(5) Land Held on Behalf of Partner**

Land held on behalf of Partner consists of a parcel of land (the Additional Property) appraised at \$7,200,000 (carrying value of \$632,335). This parcel of land was transferred to the Partnership merely as an accommodation to the Partnership in connection with obtaining the financing from AFICA (refer to note 7) on the date of the amended Partnership agreement (September 28, 2000) and will be returned to Betterroads, at the sole expense of Betterroads, as promptly as practicable after all applicable government permits are obtained for the segregation of the Additional Property.

**(6) Note Payable to Partner**

The note payable to partner consists of a revolving line-of-credit agreement for up to \$1 million entered by the Partnership with Betterroads on December 30, 1999. The note bears interest at 2% over and above the prime rate and matured on July 1, 2003. During 2003, this note was amended to extend the termination date to July 1, 2004. This note is subordinated to the Puerto Rico Tourism Development Fund (TDF), and the interest under this note may only be paid from excess cash flow, as defined in the letter-of-credit agreement (refer to note 7). Interest is payable on the last day of each month for the actual number of days elapsed. Prime rate at December 31, 2003 and 2002 was 6.00% and 6.25%, respectively. Balance of the note payable as of December 31, 2003 and 2002 was \$484,365 and \$63,008, respectively. Interest incurred as of December 31, 2003 and 2002 amounted to \$25,642 and \$15,328, respectively, of which \$23,323 and \$13,009 have been capitalized as part of project under development in 2003 and 2002, respectively.

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**(7) Loan Payable**

The Partnership entered into an \$18 million loan agreement with AFICA to finance a portion of the Project. In connection with the loan agreement, AFICA issued the same principal amount in Tourism Revenue Bonds, 2000 Series A. The bonds were purchased by the underwriters at an aggregate original discount of \$437,430 and are payable solely from revenue derived by AFICA under the loan agreement with the Partnership and from other moneys pledged for payment under the indenture of trust. The AFICA bonds are secured by an irrevocable and unconditional letter of credit of TDF, a subsidiary of the Government Development Bank for Puerto Rico (an instrumentality of the Commonwealth of Puerto Rico). The bond type, interest rate yield, original maturity, outstanding amount, and unamortized original issue discount are as follows:

<u>Bond type</u>	<u>Interest rate/yield (%)</u>	<u>Original maturity</u>	<u>Outstanding amount at December 31, 2003</u>	<u>Outstanding amount at December 31, 2002</u>
Serial	6.50 – 6.80	June 20, 2005 – December 20, 2011	\$ 2,235,000	2,235,000
Term	7.000 – 7.125	December 20, 2018 – December 20, 2030	15,765,000	15,765,000
		Unamortized original issue discount	<u>(397,662)</u>	<u>(409,983)</u>
			<u>\$ 17,602,338</u>	<u>17,590,017</u>

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Under the loan agreement, the Partnership is required to maintain construction, bond, and debt service reserve funds. The funds deposited with a trustee are restricted and will be used to pay construction costs and debt service (principal and interest). The trustee has deposited the proceeds of the issuance in several interest-bearing accounts with the Government Development Bank for Puerto Rico and a commercial bank in Puerto Rico. The Partnership has not required collateral or other security to support the deposits, nor are these guaranteed or insured by any authority, agency, or instrumentality of the United States or the Commonwealth of Puerto Rico, except for deposits under \$100,000 held by the commercial bank which are insured by the Federal Deposit Insurance Corporation. Accordingly, in the event of insolvency, receivership, or conservatorship, the Partnership may not be able to access the funds. At December 31, 2003 and 2002, the trust funds, amounting to \$9,661,744 and \$17,543,434, respectively, were held in interest-bearing deposits. The type, rate, and outstanding amount of such interest-bearing deposits are as follows:

Type	Rate	December 31	
		2003	2002
Construction fund	6.80%	\$ 5,265,425	13,142,354
Operating deficit reserve fund	6.80%	3,620,000	3,620,000
Debt service reserve fund	6.90%	776,319	781,080
		<b>\$ 9,661,744</b>	<b>17,543,434</b>

Concurrent with the loan agreement, the Partnership entered into a guaranty and reimbursement agreement (the Letter of Credit Agreement) with TDF (Guarantor), which provides that the Partnership will reimburse TDF for any amounts funded by them pursuant to the above-mentioned irrevocable and unconditional letter of credit. This agreement is secured by liens on substantially all the assets of the Partnership, including a pledge of a mortgage note for \$18 million (the amount equal to the principal amount of the bonds). The mortgage note is secured by a first mortgage on substantially all the personal property of the Partnership and a first priority security interest on substantially all the personal property of the Partnership, including the Partnership's rights under various agreements and funds held in various accounts.

In consideration of the aforementioned Letter of Credit Agreement, the Partnership agreed to pay to TDF, on each interest payment date, a letter of credit fee of: (i) one-twelfth of 1.5%, with respect to the period commencing on the date of issuance and ending on September 19, 2007 (provided the Partnership complies with debt coverage ratio requirements); (ii) one-twelfth of 2% with respect to the period commencing on September 20, 2007 and ending September 19, 2015; (iii) one-twelfth of 2.5%, with respect to the period commencing on September 20, 2015 and ending on September 19, 2020; (iv) one-twelfth of 3%, with respect to the period commencing on September 20, 2020 and ending on September 19, 2025; and (v) one-twelfth of 3.5%, with respect to the period commencing on September 20, 2025 and ending on December 30, 2030, of the sum of the product of the aggregate principal amount of the bonds outstanding on such interest payment date, plus interest on such principal, less the average daily amounts which have been on deposit in the debt service reserve, the operating deficit reserve, the excess cash flow reserve, or the bond fund reserve since the immediately preceding interest payment date. In addition, the Partnership shall pay to TDF an amount equal to \$3,000 for each interest, principal, or reserve fund deficiency drawing made by the trustee under the letter of credit.

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The Partnership has agreed, under the loan agreement that during each of its taxable years while the bonds are outstanding it will comply with certain source of income requirements. Should the Partnership fail to comply with any of these requirements, it will be required to pay additional interest, subject to certain limitations, to each qualifying bondholder. Management believes that the Partnership has complied with such source of income requirements.

The bonds maturing on or after June 20, 2008, are subject to redemption, at the option of the borrower, in whole or in part, as directed by the Partnership, at any time on or after June 20, 2008, at the redemption price plus declining premiums as set forth herein:

<u>Redemption period</u>	<u>Premiums</u>
June 20, 2008 to June 19, 2009	2%
June 20, 2008 to June 19, 2010	1%
June 20, 2010 and thereafter	0%

To exercise the foregoing optional redemption, the borrower is required to deposit with the trustee moneys necessary to effect such redemption on the 94<sup>th</sup> day immediately preceding the date on which the corresponding redemption price is due and payable. The written consent of the letter of credit issuer shall be required for any optional redemption in whole or in part if there exists an event of default or an event has occurred which if not cured would constitute an event of default under the Letter of Credit Agreement. The letter of credit does not cover any premium payable in connection with any such optional redemption.

**(8) Partnership Allocations and Distributions**

Pursuant to the amendment and restatement of the Partnership agreement dated September 28, 2000, the interest of the partners in the Partnership is as follows: Betterroads – 83%; Díaz – 10%; and PFP – 7%. The Partnership agreement does not provide for the allocation of net profit or loss under accounting principles generally accepted in the United States of America. The allocations for the years ended December 31, 2003 and December 31, 2002 have been made in accordance with the percentage of interest of each partner.

For income tax purposes, each partner shall, for each taxable year, include in its gross income its distribution share in the net income of the Partnership. All losses generated by the Partnership shall be allocated between Betterroads and PFP; such allocation shall be made in the following proportions: 93% to Betterroads and 7% to PFP.

All tax credits generated pursuant to the tax concession issued under the Tourism Development Act of 1993, as amended, shall be allocated between Díaz and Betterroads; such allocation shall be made in the following proportions: 19% for Díaz and 81% for Betterroads.

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The Partnership shall distribute, from time to time, in such amounts as partners representing the majority of the Partnership interest agree, any available cash flow (as defined in the Partnership agreement) to the partners according to their respective Partnership interest from time to time in the following priority: (i) to pay the Puerto Rico income tax liability of Betterroads, Díaz, and PFP arising solely by reason of its Partnership interests; (ii) to repay PFP an amount equal to its federal tax liability arising solely by reason of its Partnership interest; (iii) to repay the partners on a pro rata basis any contribution loan made by them in accordance with the provisions of the partners' agreement; (iv) to repay the partners on a pro rata basis any additional capital contributions (as defined in the partnership agreement) made by them in accordance with the provisions of Partnership agreement; (v) 83% to Betterroads, 10% to Díaz, and 7% to PFP, provided that distribution of available cash flow to Betterroads under the first item above mentioned and to PFP under the second item above mentioned shall be set off against these distributions to be made. Additionally, the Partnership agreement provides for certain put and call rights among the partners.

The above represents a summary of the most significant provisions; (refer to the Partnership agreement (as amended on September 28, 2000) for a more complete description of allocations and distributions).

**(9) Tax Concession**

The Puerto Rico Tourism Company has granted the Partnership a tax concession for a period of 10 years commencing in the year in which the Partnership commences its exempted tourism activity with respect to income generated from the golfers who come from the Hotel as follows:

	<u>Exemption rate</u>
Municipal, personal, and real property taxes	90%
Income tax expense	90%
License fees, excise taxes, and other municipal taxes	100%
Municipal construction excise taxes	100%
Excise tax assessed on articles for use and consumption	100%

The tax concession requires the Partnership to comply with the provisions of the Tourism Development Act, the regulations issued pursuant to the Tourism Development Act, the terms of the tax concession granted to the Partnership, and certain filing requirements provided by the Code. Failure of the Partnership to comply with these requirements could result in the revocation of the tax concession and the elimination of all the exemptions provided by the Tourism Development Act.

**(10) Subsequent Event**

In January 2004, the Partnership filed an application for approval from (a) AFICA to issue additional Tourism Revenue Bonds (AFICA Bonds) amounting to \$7.5 million and to lend the proceeds thereof to the Partnership, and (b) TDF for a letter of credit to secure the AFICA Bonds. The Partnership will use the proceeds of the AFICA Bonds to finance, in part, the additional cost necessary for the completion of the development, construction, and equipping of the Project.

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In March 2004, with the opening of the Paradisus Puerto Rico Hotel, the Partnership began operating one of the 18-hole championship golf courses. Other related facilities, including the clubhouses and the remaining 18-hole championship golf course, are currently under development. The facilities under development are scheduled to open during 2004.

**THE PROJECT**

The Project, known as the Coco Beach Golf & Country Club, is expected to consist of two 18-hole championship golf courses, a clubhouse and related facilities. It will provide four different playing experiences as it consists of four 9-hole courses with different settings, such as mountains, oceansides, wetlands and lakeside settings. The Project is located on approximately 520 *cuerdas* of land in the Municipality of Río Grande on the Northeast coast of Puerto Rico. The Project is located approximately 21 miles East of the Luis Muñoz Marín International Airport. Its primary access route from the San Juan metropolitan area is Puerto Rico Highway No. 3, a four-lane divided highway. The Project is part of a resort master plan (the “Master Plan”) prepared by Willowbend to develop two hotels, two golf courses, timeshare units and residential properties on approximately 980 *cuerdas* of a peninsula known as *Punta Miquillos* and a portion of land south of the peninsula (the “Resort”). The Project is located next to the Paradisus Puerto Rico Hotel, which is a 486-room luxury beach hotel and resort (the “Hotel”). The Hotel is the only European-chain hotel in Puerto Rico. The Hotel owner, Desarrolladora del Norte, is developing a second phase that may include 300 additional rooms and/or timeshare units for a total of over 791 rooms and/or timeshare units at the Hotel.

**Facilities and Construction of the Project**

The Project has been developed in two phases. The first phase entails the construction of the first 18-hole championship golf course, a clubhouse for the two golf courses and the installation of the land and irrigation system for the second golf course. The second phase consists of the construction of the second 18-hole golf course. All 36 holes of championship golf have been designed by PGA Tour Professional Tom Kite in collaboration with Bruce Besse of Willowbend Golf & Land Design.

The first 18-hole golf course comprises two 9-hole half courses named the Lakes Course and Ocean Course, having wide fairways, big greens and lakes. The construction of the first 18-hole golf course has been completed.

The second 18-hole golf course will comprise two 9-hole courses to be known as Mountain Course and Wetland Course featuring vegetation, wild life and elevation changes. In addition, these two courses will have some holes located next to the wetlands of the Espíritu Santo River and will offer panoramic views of the Atlantic Ocean, Comezón Bay (East of the peninsula) and *Punta Miquillos*. As of the date hereof, the construction of the second 18-hole golf course is 80% completed.

The Project will include a full service, first-class 46,000 square feet clubhouse considered the largest clubhouse in the Caribbean, which will be located on the eastern part of the peninsula and elevated to take advantage of scenic ocean views. The clubhouse has been designed and will be furnished in a traditional Spanish pallet, featuring Puerto Rican artwork and decoration. The clubhouse will include a restaurant, to be known as the *Grille Room*, with a 125-seat capacity, and an adjacent private lounge with sitting for 62 additional people. The *Grille Room*'s design will be consistent with the traditional Spanish architecture of the clubhouse. The clubhouse will also feature a 212-seat ballroom with a 3,000 square feet with state-of-the-art technology enhancements designed for high performance meetings.

Additional facilities will include a full service golf pro shop, indoor cart storage, golf bag storage area and administrative offices. Both the men's and women's locker rooms will feature Jacuzzi hot tubs, steam rooms, full showers and sanitary facilities along with an assortment of full and half size lockers. As of the date hereof, the construction of the Clubhouse is 85% completed.

From the date of issuance of the 2004 Bonds, the Project will take approximately 5 months to complete, and until such time the Borrower will only operate the Lakes and Ocean Courses. Such courses have been in use since March 2004.

The Borrower retained PFP Golf Construction L.P., S.E. (the “Construction Manager”), a subsidiary of Willowbend, to assist it in selecting and supervising the independent contractors for the different components of the

Project. The Borrower has also engaged an affiliate of Willowbend, Willowbend Golf Management Coco Beach L.P., S.E. (as successor of PFP Golf Management, L.P., S.E.) to operate the Project pursuant to a club management agreement (the "Management Agreement").

The Project will be maintained at a standard equal to the standard for the maintenance of the Hotel. Pursuant to a land contribution agreement (the "Land Contribution Agreement") by and among Betterroads, Coco Beach Development, CBM Investment Corporation, Meliá Inversiones Americanas, N.V., a Netherlands company, and Desarrolladora del Norte, in the event that at any time the Borrower, as Coco Beach Development's designee, fails to maintain the Project in accordance with this standard, Desarrolladora del Norte will provide written notice thereof to the Borrower granting the Borrower 45 days to cure such default. If the Borrower diligently pursues the cure of such default and such default cannot be cured within the aforesaid 45-day period, such period will be extended for as long as it is necessary for the Borrower to cure the default. If the Borrower fails to cure such default within such 45-day period (as such period may be extended), Desarrolladora del Norte will have the right to enter the Project and cure the default at the Borrower's expense.

### **Construction of the Project**

From the date of issuance of the 2004 Bonds, the Project will take approximately 5 months to complete. The construction of the first 18-hole golf-course has been completed. The construction of the second 18-hole golf course comprised of Mountain and Wetland course is 80% completed.

The construction of the clubhouse is 85% completed. Some areas of the clubhouse have been completed to serve the golf customers upon the opening of the Hotel and the first 18-hole golf course. Completion of the main building and other facilities are expected for December 31, 2004.

The Borrower has retained PFP Golf Construction L.P., S.E. (the "Construction Manager"), a subsidiary of Willowbend, to assist it in selecting and supervising the independent contractors for the different components of the Project. The Construction Manager will also supervise compliance by the contractors with the design, plans and specifications of the Project.

### **Operation of the Project**

The Borrower has engaged a subsidiary of Willowbend, Willowbend Golf Management Coco Beach L.P., S.E. (as successor of PFP Golf Management, L.P., S.E.) ("Willowbend Management"), a Delaware limited partnership which has elected to be treated as a special partnership under the Code, to operate the Project pursuant to a club management agreement (the "Management Agreement"). The original term of the Management Agreement is 15 years commencing on March 2004, the date the first 18-hole golf course was completed and ready for use by paying customers. In exchange for its services, Willowbend Management will receive a management fee equal to 3.5% of the gross revenues of the Project. Willowbend Management will have the option to extend the term of the Management Agreement after the original term thereof for up to two additional 10-year terms; provided, however, that if in the three year period prior to the last year of the initial term or any renewal term thereof the combined profits of the Project are 15% below the approved budgets, then the renewal option may be exercised only by the Borrower.

### **Use and Access Agreement**

The Borrower has entered into a use and access agreement (the "Use and Access Agreement") with Desarrolladora del Norte. Under the Use and Access Agreement, Hotel guests have the right to access and use the Project's facilities and common areas subject to rules regarding such access and use as are deemed advisable from time to time by the Borrower. The Use and Access Agreement has an initial term of 10 years (which began on March, 2004), renewable for successive one year terms. Furthermore, the Borrower grants Hotel guests priority over its club members, guests of other hotels at the Resort, residents of the Resort and the public at large in reserving (on 48-hour prior reservation) 20% of the tee times for the period from 7:00 a.m. to 12:00 p.m. and from 12:00 p.m. to 3:00 p.m.



Pursuant to the Use and Access Agreement, the Borrower provides Hotel guests with a 5% discount off the rack rates applicable to outside hotel golf players as in effect on the date each round is played. In consideration for such discount, Desarrolladora del Norte grants to the Borrower the right, free of charge, to place brochures and other advertising material in rooms at the Hotel and to advertise the golf courses in the areas of the Hotel designated by Desarrolladora del Norte for advertising by concessionaires and others providing services to Hotel guests. All such advertising materials are subject to the approval of Desarrolladora del Norte. Under the Use and Access Agreement, the Project's club members have the right to use the Hotel's facilities, subject to availability of such facilities, after satisfying the needs of Hotel guests and to the payment of such fees or charges imposed by Desarrolladora del Norte from time to time for the use of such facilities by non-guests of the Hotel.

### **License Agreement**

The Borrower has entered into a license agreement (the "License Agreement") with Coco Beach Development pursuant to which the latter granted to the Borrower, at not cost or expense, the non-exclusive, gratuitous right to use the name "Coco Beach" and the logos, trademarks and trade names associated with such name in connection with the operation of the Project.

### **Real Estate Matters**

#### **Right of First Offer**

Pursuant to the Land Contribution Agreement, if the Borrower decides to sell or convey the Project to a third party other than an affiliate or partner of the Borrower, or receives a bona fide purchase offer from a third party (other than Willowbend or one of its affiliates), Desarrolladora de Norte has the right of first offer to purchase the Project. If Desarrolladora del Norte does not exercise its right of first offer in such circumstances, then the Borrower may offer to sell the Project to any third-party purchaser or accept the purchase offer from a third-party.

#### **Tourism District**

Pursuant to the Land Contribution Agreement, the Borrower will consent to the inclusion of the project parcel in any tourism improvement district (the "Tourism District") proposed by Coco Beach Development for the Resort under the Puerto Rico Tourism Districts Improvement Act of 1998. The Tourism District may impose special assessments on all real property located within the district for the maintenance of common areas thereat and for the establishment of reserves for the replacement, refurbishment or improvement of common facilities on the district.

#### **Restrictive Covenants**

The Borrower has entered into a deed of restrictive covenants with CBM Investment Corporation, Coco Beach Development and Desarrolladora del Norte pursuant to which all roads within the Resort will remain private and never dedicated to public use unless so required by a governmental agency or municipality; requiring that the Project parcel will always be used for the operation of golf courses; requiring that all developments in the Resort parcel be residential developments (as contemplated in the Master Plan) or an "eligible business" (as defined in the Puerto Rico Tourism Development Act of 1993, as amended, and consistent with the Master Plan); and requiring that all owners of land in the Resort, including the Project parcel, contribute proportionally to the cost of security, repair and maintenance of the common areas of the Resort.

**CAPITAL APPRECIATION BOND'S ACCRETION TABLE**  
**(per \$5,000 of amount due at maturity)**

<u>Date</u>	<u>Accreted Value</u>
08/20/2004	3,986.10
12/20/2004	4,065.45
06/20/2005	4,187.40
12/20/2005	4,313.00
06/20/2006	4,442.40
12/20/2006	4,575.70
06/20/2007	4,712.95
12/20/2007	4,854.35
06/20/2008	5,000.00

**APPENDIX C-2**

<b>Mandatory Redemption Date</b>	<b>Mandatory Redemption Requirement</b>
December 20, 2008	\$75,000.00
June 20, 2009	\$75,000.00
December 20, 2009	\$80,000.00
June 20, 2010	\$80,000.00
December 20, 2010	\$85,000.00
June 20, 2011	\$85,000.00
December 20, 2011	\$90,000.00
June 20, 2012	\$90,000.00
December 20, 2012	\$95,000.00
June 20, 2013	\$95,000.00
December 20, 2013	\$100,000.00
June 20, 2014	\$100,000.00
December 20, 2014	\$110,000.00
June 20, 2015	\$110,000.00
December 20, 2015	\$110,000.00
June 20, 2016	\$115,000.00
December 20, 2016	\$120,000.00
June 20, 2017	\$120,000.00
December 20, 2017	\$130,000.00
June 20, 2018	\$130,000.00
December 20, 2018	\$135,000.00
June 20, 2019	\$140,000.00
December 20, 2019	\$140,000.00
June 20, 2020	\$150,000.00
December 20, 2020	\$150,000.00
June 20, 2021	\$155,000.00
December 20, 2021	\$160,000.00
June 20, 2022	\$165,000.00
December 20, 2022	\$170,000.00
June 20, 2023	\$175,000.00
December 20, 2023	\$180,000.00
June 20, 2024	\$190,000.00

<b>Mandatory Redemption Date</b>	<b>Mandatory Redemption Requirement</b>
December 20, 2024	\$190,000.00
June 20, 2025	\$200,000.00
December 20, 2025	\$200,000.00
June 20, 2026	\$210,000.00
December 20, 2026	\$215,000.00
June 20, 2027	\$225,000.00
December 20, 2027	\$225,000.00
June 20, 2028	\$240,000.00
December 20, 2028	\$240,000.00
June 20, 2029	\$255,000.00
December 20, 2029	\$255,000.00
June 20, 2030	\$270,000.00
December 20, 2030	\$270,000.00
June 20, 2031	\$285,000.00
December 20, 2031	\$285,000.00
June 20, 2032	\$300,000.00
December 20, 2032	\$305,000.00
June 20, 2033	\$325,000.00
December 20, 2033	\$320,000.00
June 20, 2034	\$345,000.00

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Basic Financial Statements and Required Supplementary Information

June 30, 2003

(With Independent Auditors' Report Thereon)

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

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## **Independent Auditors' Report**

Board of Directors of  
Puerto Rico Tourism Development Fund:

We have audited the accompanying balance sheet of Puerto Rico Tourism Development Fund (the Tourism Fund), a component unit of the Government Development Bank for Puerto Rico, as of June 30, 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Tourism Fund'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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.

As discussed in note 1(f) to the financial statements, the concentration of risk in the guarantees issued by the Tourism Fund, as well as the limited historical loss experience and other factors compound the uncertainty of management's estimate of the allowance for losses on guarantees. As a result, the aggregate losses ultimately incurred by the Tourism Fund may differ from the allowance for losses on guarantees as reflected in the accompanying financial statements, and such difference may be material. As also discussed in note 1(f) to the financial statements, losses incurred on guarantees exceeding the fees and charges collected by the Tourism Fund, if any, are subject to reimbursement by the Commonwealth of Puerto Rico. However, the Legislature of the Commonwealth is not legally obligated to authorize such appropriations.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Puerto Rico Tourism Development Fund as of June 30, 2003, and the changes in its financial position and 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 3 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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 the information and express no opinion on it.

KPMG LLP

October 10, 2003, except as to note 13,  
which is dated June 30, 2004

Stamp No. 1988325 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis

June 30, 2003

As financial management of the Puerto Rico Tourism Development Fund (the Tourism Fund), we offer readers of the Tourism Fund's financial statements this narrative overview and analysis of the Tourism Fund's financial performance during the fiscal year ended June 30, 2003. We encourage readers to read the information presented here in conjunction with the basic financial statements, which follow this section.

**(1) Financial Highlights**

- Total assets and net assets amounted to \$131.5 million and \$96.1 million, respectively, at June 30, 2003.
- Change in net assets for the year amounted to a reduction of \$6.5 million.
- The year ended with an operating loss of \$8.5 million, an increase of \$6.5 million over the operating loss of fiscal year 2002. Operating expenses increased \$7.2 million or 78% primarily as a result of a specific provision recorded for the guarantee on the AFICA Cayo Largo bonds.
- At June 30, 2003, outstanding guarantees and letters of credit commitments stood at \$563 million, compared to \$606 million at June 30, 2002.

**(2) Overview of the Financial Statements**

This report includes this management's discussion and analysis section, the independent auditors' report and the basic financial statements of the Tourism Fund. The basic financial statements also include notes that explain in more detail some of the information in the basic financial statements.

**(3) Required Financial Statements**

The financial statements of the Tourism Fund report information using accounting methods similar to those used by private sector enterprises. The balance sheet provides information about the nature and amounts of investments in resources (assets) and the obligations to Tourism Fund creditors (liabilities). It also provides the basis for evaluating the capital structure of the Tourism Fund and assessing its liquidity and financial flexibility.

Revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net assets. This statement measures the success of the Tourism Fund's operations over the past year and can be used to determine whether the Tourism Fund has successfully recovered its costs from the revenues it generates.

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 operating, 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 of the Tourism Fund**

The balance sheet and the statement of revenues, expenses, and changes in net assets report information about the Tourism Fund's activities in a way that will help determine whether the Tourism Fund as a whole is better or worse financially as a result of this year's activities. These two statements report the net assets of the Tourism Fund and the changes in them. One can think of the Tourism Fund's net assets – the difference between assets and liabilities – as one way to measure financial health or financial position.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis

June 30, 2003

Over time, increases or decreases in the Tourism Fund's net assets are one indicator of whether its financial health is improving or deteriorating. However, it is important to consider other nonfinancial factors such as changes in economic conditions particularly in the tourism industry, and new or changed government legislation.

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

	<b>June 30</b>		<b>Change</b>	
	<b>2003</b>	<b>2002</b>	<b>\$</b>	<b>%</b>
Assets	\$ 131,467	137,181	(5,714)	(4)%
Current liabilities	\$ 9,141	20,477	(11,336)	(55)%
Noncurrent liabilities	26,253	14,116	12,137	86%
Total liabilities	35,394	34,593	801	2%
Unrestricted net assets	96,073	102,588	(6,515)	(6)%
Total liabilities and net assets	\$ 131,467	137,181	(5,714)	(4)%

Total assets decreased by \$5.7 million or 4% during the year. This decrease is due to the negative operating results, which consumed assets. Revenues were not sufficient to cover the provision for losses on guarantees and letters of credit recorded during the year.

The decrease in current liabilities results from the classification of the specific allowance on the AFICA Ritz Carlton bonds guarantee as a current liability at June 30, 2002 in anticipation of the sale of the collateral of this guarantee in September 2002 (see note 8).

The increase in noncurrent liabilities is primarily due to the provision of \$10.5 million as a specific allowance for the Cayo Largo Intercontinental Beach Resort project guarantee (see notes 10 and 13).

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis

June 30, 2003

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

	<b>Year ended June 30</b>		<b>Change</b>	
	<b>2003</b>	<b>2002</b>	<b>\$</b>	<b>%</b>
Operating revenues and expenses:				
Guarantee fees and other	\$ 7,970	7,244	726	10%
Operating expenses	16,488	9,258	7,230	78%
Operating loss	(8,518)	(2,014)	(6,504)	323%
Investment income, net of nonoperating expenses	2,003	3,114	(1,111)	(36)%
Income (loss) before contribution	(6,515)	1,100	(7,615)	(692)%
Contribution	—	50,000	(50,000)	(100)%
Changes in net assets	(6,515)	51,100	(57,615)	(113)%
Beginning net assets	102,588	51,488	51,100	
Ending net assets	\$ 96,073	102,588	(6,515)	

The increase of \$726,000 in guarantee fees and other revenues includes \$312,000 related to the Marriott by Courtyard guarantee that was originated during the year. The increase in operating expenses is directly related to the specific provision recorded for the Cayo Largo project (see notes 10 and 13). The decrease in investment income is due both to a lower average balance of interest earning assets and to the cancellation early in the year of a \$7 million guaranteed investment contract with the Government Development Bank for Puerto Rico (the Bank) with an interest rate of 5.375% and the reinvestment of the proceeds at a lower rate.

No contribution from the Bank was received during the year. The \$50 million contribution received in 2002 had the purpose of increasing the guaranteeing capacity of the Tourism Fund.

**(5) Subsequent Events**

As indicated in note 13 to the basic financial statements, on August 6, 2003, the Tourism Fund initiated foreclosure on the mortgage note it holds as collateral for the guarantee on the AFICA Cayo Largo bonds. The indenture of the AFICA Cayo Largo bonds requires the repayment of the bonds before the execution of the mortgage note. Therefore, in order to execute the mortgage note, the Tourism Fund obtained a line of credit from the Bank just prior to filing the foreclosure action, with which the Tourism Fund called the outstanding balance of the AFICA Cayo Largo bonds. Said bonds amounted to \$75.3 million. Management believes that the specific allowance that has been established for this project, which is included as part of the noncurrent portion of the allowance for losses on guarantees and letters of credit, is adequate.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis

June 30, 2003

Resulting from the above-mentioned foreclosure proceedings, several of the principals of the Cayo Largo Hotel development (Cayo Largo Resort Associates, Cayo Largo Hotel, and D. Group Equity Holdings) have counterclaimed by filing complaints for alleged damages and breach of contract by the Tourism Fund aggregating to approximately \$165 million. In addition, United States Fidelity and Guaranty Company (the insurer) has filed an action to obtain a declaration that it is not bound to perform under the performance and payment bond executed in connection with the construction and development of the project. All the counterclaims and other actions, the last of which was filed on February 11, 2004, are in early discovery stages.

On November 3, 2003, the Tourism Fund obtained a line of credit from the Bank for a maximum of \$155.3 million with the sole purpose of refinancing the AFICA Río Mar Associates bonds which the Tourism Fund guarantees. Said bonds were redeemed on December 22, 2003.

On January 30, 2004, the Tourism Fund obtained a line of credit from the Bank for a maximum of \$28.0 million with the sole purpose of redeeming the AFICA Martineau Bay Resort bonds. On February 5, 2004, the Tourism Fund redeemed said bonds and on March 19, 2004, the Tourism Fund obtained ownership of the Martineau Bay Resort property. Currently, the Tourism Fund is evaluating the alternatives to sell the property to a third party. Management believes that the specific allowance that has been established for this project is adequate.

**(6) Contacting the Tourism Fund's Financial Management**

This financial report is designed to provide a general overview of the Tourism Fund's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Puerto Rico Tourism Development Fund, PO Box 42001, San Juan, Puerto Rico, 00940-2001.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Balance Sheet

June 30, 2003

**Assets**

Current assets:	
Cash (note 3)	\$ 6,337,368
Time deposit (note 4)	30,239,447
Investments (note 5)	68,576,780
Guarantee fees receivable	152,070
Accrued interest receivable	329,268
Total current assets	105,634,933
Noncurrent assets:	
Investments (note 5)	25,608,128
Investment in special partnerships (note 6)	217,747
Loan receivable, net (note 7)	—
Other assets	6,476
Total assets	\$ 131,467,284

**Liabilities and Net Assets**

Current liabilities:	
Allowance for losses on guarantees and letters of credit (notes 8 and 13)	\$ 2,036,905
Deferred gain (note 9)	3,000,000
Escrow deposit (note 10)	2,931,507
Unearned guarantee fees	740,554
Accounts payable and other liabilities	432,160
Total current liabilities	9,141,126
Noncurrent liabilities:	
Allowance for losses on guarantees and letters of credit (notes 8 and 13)	26,253,215
Total liabilities	35,394,341
Commitments and contingencies (note 8)	
Unrestricted net assets (note 12)	96,072,943
Total liabilities and net assets	\$ 131,467,284

See accompanying notes to basic financial statements.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2003

Operating revenues:	
Guarantee fees (note 8)	\$ 7,665,473
Other	304,665
	<u>7,970,138</u>
Operating expenses:	
Provision for loan losses (note 7)	1,275,000
Provision for losses on guarantees and letters of credit (note 8)	14,363,575
Professional fees	435,456
Management fees to Government Development Bank for Puerto Rico (note 11)	213,337
Other	200,879
	<u>16,488,247</u>
Total operating expenses	<u>16,488,247</u>
Operating loss	<u>(8,518,109)</u>
Nonoperating revenues:	
Interest income (notes 4 and 5)	1,913,198
Net increase in fair value of investments	94,785
	<u>2,007,983</u>
Total nonoperating revenues	<u>2,007,983</u>
Nonoperating interest expenses	<u>4,738</u>
Change in net assets	<u>(6,514,864)</u>
Net assets, beginning of year	<u>102,587,807</u>
Net assets, end of year	<u>\$ 96,072,943</u>

See accompanying notes to basic financial statements.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Statement of Cash Flows

Year ended June 30, 2003

Cash flows from operating activities:	
Guarantee fees collected	\$ 8,274,649
Disbursements for guaranteed obligations	(18,899,339)
Distributions from investment in limited liability company	6,543,991
Management fees paid to Government Development Bank for Puerto Rico	(213,337)
Payments to service providers	(545,945)
Net cash used in operating activities	<u>(4,839,981)</u>
Cash flows provided by noncapital financing activities:	
Net increase in escrow deposit	2,931,507
Interest payments	(4,738)
Net cash provided by financing activities	<u>2,926,769</u>
Cash flows from investing activities:	
Net decrease in time deposits and nonparticipating investment contracts	10,364,939
Proceeds from redemptions and maturities of investments	94,568,527
Purchase of investments	(172,412,559)
Origination of loans	(1,275,000)
Interest received	1,909,963
Net cash used in investing activities	<u>(66,844,130)</u>
Net decrease in cash	(68,757,342)
Cash, beginning of year	<u>75,094,710</u>
Cash, end of year	<u><u>\$ 6,337,368</u></u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	<u>\$ (8,518,109)</u>
Adjustments to reconcile operating loss to net cash used in operating activities:	
Provision for losses on guarantees and letters of credit	14,363,575
Provision for loan losses	1,275,000
Decrease in guarantee fees receivable	866,406
Decrease in unearned guarantee fees	(257,230)
Decrease in investment in limited liability company, net	3,543,991
Decrease in other assets	123,468
Disbursements for guaranteed obligations	(18,899,339)
Increase in deferred gain	3,000,000
Decrease in other liabilities	(337,743)
Total adjustments	<u>3,678,128</u>
Net cash used in operating activities	<u><u>\$ (4,839,981)</u></u>
Noncash transactions:	
Increase in fair value of investments	\$ 94,785

See accompanying notes to basic financial statements.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

June 30, 2003

**(1) Reporting Entity**

Puerto Rico Tourism Development Fund (the Tourism Fund) is a component unit of the Government Development Bank for Puerto Rico (the Bank).

The Tourism Fund was created by resolution of the Bank's board of directors in 1993 to promote the hotel and tourism industry of the Commonwealth of Puerto Rico (the Commonwealth) by making capital investments in, or by providing financing directly or indirectly (though the use of letters of credit and guarantees) to entities that can contribute to the development of this industry. The Tourism Fund is exempt from taxation in Puerto Rico.

**(2) Summary of Significant Accounting Policies**

The Tourism Fund applies all applicable Governmental Accounting Standards Boards (GASB) pronouncements, as well as the following pronouncements issued before and after November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements: statements and interpretations issued by the Financial Accounting Standards Boards, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures.

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.

Following is a description of the Tourism Fund's most significant accounting policies:

**(a) Measurement Focus and Basis of Accounting**

Proprietary fund 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.

**(b) Operating Revenues and Expenses**

Proprietary funds distinguish operating revenues and expenses from nonoperating items. The principal operating revenues of the Tourism Fund are guarantee fees collected from developers of tourism projects and interest income on direct financings of tourism projects. Gains and losses arising from the sale of investments in tourism projects are also reported as operating revenue. Operating expenses include the provision for losses on guarantees and letters of credit, interest expense on borrowings used as funding for the direct financing of tourism projects and those expenses related to the administration of the entity. All other revenues and expenses not meeting these criteria are reported as nonoperating revenues and expenses.

**(c) Guarantee and Other Fees**

Guarantee and other fees collected in advance are amortized over the life of the related guarantee.



**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

June 30, 2003

**(d) *Investments and Investment Contracts***

Investments and investment contracts are carried at fair value, except for money market investments, participating investment contracts with a remaining maturity at the time of purchase of one year or less and nonparticipating investment contracts which are carried at cost; and an investment position in a 2a-7 like external investment pool which is carried at the pool's share price. Fair value is determined based on quoted market prices and quotations received from independent brokers/dealers. In accordance with investment policies approved by the board of directors, the Tourism Fund invests in certain mortgage and asset-backed securities and in corporate bonds and external investment pools. These securities are reported at fair value in the accompanying balance sheet. The fair values of mortgage and asset-backed securities are based on cash flows from principal and interest payments on the underlying mortgages or assets and are therefore sensitive to prepayments.

**(e) *Investment in Special Partnerships***

The investment in special partnerships is reported using the equity method.

**(f) *Allowance for Losses on Guarantees and Letters of Credit***

Management periodically evaluates the credit risk inherent in the guarantees and letters of credit issued, based on the Tourism Fund's past net cash outlays in connection with the related guarantees, known and inherent risk in the portfolio, adverse situations that may affect the particular projects under the guarantees, and current economic conditions. The Tourism Fund charges to expense the amount required to cover estimated losses by establishing a specific allowance component for guarantees and letters of credit related to loans in default (determined on the basis of the estimated future net cash outlays in connection with the related guarantees), and a general component for the risk inherent in the other guarantees and letters of credit outstanding (established as a percentage of the principal amount of the underlying loans based on management's best judgment). Any portion of the specific component of the allowance that represents expected cash outlays during the following fiscal year is presented as a current liability.

The concentration of risk in the guarantees and letters of credit issued (small number of large guarantees, geographical concentration in Puerto Rico, industry concentration in hotel and tourism) as well as the limited historical loss experience and other factors compound the uncertainty inherent in the estimate of the allowance for losses on guarantees and letters of credit. As a result, the aggregate losses on guarantees and letters of credit ultimately incurred by the Tourism Fund may differ from the allowance for losses as reflected in the accompanying basic financial statements, and such differences may be material.

The executive director of the Tourism Fund shall certify each year to the Director of the Office of Management and Budget of the Commonwealth of Puerto Rico the amount, if any, that is necessary to reimburse the Tourism Fund for disbursements made in the previous year and disbursements projected for the following year in connection with obligations guaranteed by the Tourism Fund, in excess of earnings from fees and charges collected on such guarantees. The Director of the Office of Management and Budget of the Commonwealth of Puerto Rico shall include such amount in the

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

June 30, 2003

General Budget of the Commonwealth for the following fiscal year for the Legislature's consideration and approval. The Legislature is not legally obligated to make such appropriations.

During the year ended June 30, 2003, the Tourism Fund initiated a process with the Office of Management and Budget to claim certain reimbursements for disbursements made under the guarantees in excess of fees and charges. Reimbursements from the Commonwealth, if any, are recorded as a receivable to the extent appropriated by the Commonwealth's Legislature.

**(3) Cash**

The depository bank balance as of June 30, 2003, representing interest-bearing demand deposits with the Bank, was \$6,337,368, and was uninsured and uncollateralized.

**(4) Time Deposit**

The time deposit with the Bank, as of June 30, 2003, bears interest at 1.00% and matures on July 29, 2003.

**(5) Investments**

The Bank's board of directors made extensive to the Tourism Fund the investment policies of the Bank. These investment policies allow management to purchase or enter into the following investment instruments:

- U.S. government and agencies obligations
- Certificates and time deposits
- Bankers acceptances
- Participations in the Puerto Rico Government Investment Trust Fund
- Obligations of the Commonwealth of Puerto Rico, its agencies, municipalities, public corporations, and instrumentalities
- Federal funds
- Securities purchased under agreements to resell
- World Bank securities
- Mortgage- and asset-backed securities
- Corporate debt, including investment contracts
- Stock of corporations created under the laws of the United States or the Commonwealth
- Options, futures, and interest-rate swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products which qualify under any of the foregoing investment categories
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
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Notes to Basic Financial Statements

June 30, 2003

The investment policies also establish limitations and other guidelines.

Investment securities, at fair value (which is the same as carrying amounts), as of June 30, 2003, consist of:

Obligations of the U.S. government, its agencies and instrumentalities	\$ 61,344,329
External investment pool	26,442,452
Asset-backed securities	1,285,627
Corporate bonds	<u>5,112,500</u>
Total	<u>\$ 94,184,908</u>

The external investment pool above is the Puerto Rico Government Investment Trust Fund. It is a no-load diversified collective investment trust administered by the Bank.

All investment securities as of June 30, 2003, were insured and/or held by the Tourism Fund or its agent in the Tourism Fund's name.

**(6) Investment in Special Partnerships**

On August 15, 2001, the Tourism Fund acquired participations of 5.31% and 2.30% in Dorado Golf S.E. and Hotel Dorado, S.E., respectively (the partnerships), as consideration for issuing a standby letter of credit to secure AFICA bonds in the amount of \$5,975,000 that were used by the partnerships to finance certain cost overruns from the construction of the Embassy Suites Hotel & Casino-Dorado project. At June 30, 2003, the participation in Hotel Dorado, S.E. had been diluted to 2.24%. The aggregate carrying value of these investments at June 30, 2003 amounted to \$217,747.

**(7) Loan Receivable, Net**

Loan receivable as of June 30, 2003 consists of the outstanding balance of a \$1,275,000 operating advance to a hotel for which the Tourism Fund guarantees AFICA bonds debt service payments. The balance of the loan has been fully reserved as management believes its collection is doubtful.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

June 30, 2003

**(8) Commitments and Contingencies**

At June 30, 2003, the Tourism Fund had the following outstanding guarantees and letters of credit:

Description	Outstanding commitment amount	Expiration date
The Westin Río Mar Beach Resort Project	\$ 148,810,000	December 20, 2028
Embassy Suites Hotel & Casino – Dorado Project	37,660,000	April 1, 2019
Martineau Bay Resort Project	26,725,000	September 1, 2028
Hampton Inn Hotel Project	10,355,000	September 1, 2020
Cayo Largo Intercontinental Beach Resort Project	75,330,000	December 20, 2029
Embassy Suites Hotel & Casino – San Juan Project	37,035,000	April 1, 2025
Hostal El Convento Project	8,285,000	September 1, 2020
Paradisus Coco Beach Hotel	68,290,000	December 1, 2030
Coco Beach Golf & Country Club	18,000,000	December 1, 2030
Palmas del Mar, Inc.	30,000,000	November 1, 2010
Hampton Inn, Caguas	18,885,000	November 1, 2010
Serrallés Hotel, Inc. (Ponce Hilton)	55,835,000	October 1, 2030
Marriott by Courtyard	27,846,000	September 9, 2009
Total	<u>\$ 563,056,000</u>	

Typically, the Tourism Fund guarantees the timely payment of principal and interest on the obligations issued to finance the tourism projects. It also provides other types of credit facilities such as (i) deficiency guarantees, as in the case of the Courtyard by Marriott project, where the Tourism Fund guarantees the recovery of any deficiency the lender may realize on the final disposition of the collateral and (ii) direct loans.

The Tourism Fund issued the deficiency guarantee described above on August 5, 2002 on a \$27.8 million loan taken by the buyer of the property now operated as the Marriott by Courtyard in Isla Verde. There were no other guarantees or letters of credit issued during fiscal year 2003.

On September 24, 2002, the Tourism Fund sold the mortgage note it held as collateral for the guarantee on the AFICA Ritz Carlton bonds. The sale resulted in a loss of \$13.8 million plus the disbursement of \$2.9 million in principal and interest related to the debt service payments of said bonds. The allowance for losses on guarantees and letters of credit at June 30, 2002 included a specific provision in anticipation of this loss.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

June 30, 2003

Following is the activity of the allowance for guarantees and letters of credit for fiscal year 2003:

	<b>Beginning balance</b>	<b>Provisions</b>	<b>Charges</b>	<b>Ending balance</b>
Allowance for losses on guarantees and letters of credit, noncurrent portion	\$ 32,825,884	14,363,575	(18,899,339)	28,290,120

**(9) Deferred Gain**

On August 5, 2002, the Tourism Fund realized a gain of \$3 million on the liquidation of its investment in a limited liability company. To facilitate the sale of the property collateralizing the investment, the Tourism Fund issued a deficiency guarantee on the loan taken by the buyer of the property. Therefore, the gain of \$3 million that otherwise would have been recognized, has been deferred.

**(10) Escrow Deposit**

On April 29, 2003, the Tourism Fund filed a complaint for breach of contract against Cayo Largo Hotel Associates and others after the construction of the Cayo Largo Intercontinental Beach Resort Project had come to a complete stop. In connection with this decision, the Tourism Fund requested the funds deposited by Cayo Largo Hotel Associates in certain bank for the benefit of the Tourism Fund, to be transferred to the Tourism Fund. The balance of said funds was approximately \$2.9 million at June 30, 2003 and is presented as a current liability.

**(11) Management Fees**

The Bank provides certain management and administrative services to the Tourism Fund for which the Bank charged \$213,337 during the year ended June 30, 2003.

**(12) Net Assets**

In connection with the timely payments of guarantees and letters of credit issued, management of the Tourism Fund had designated \$46,128,917 at June 30, 2003 for debt service on bonds, representing the maximum annual aggregated debt service payments on each of the bonds issued. Such amount does not include deficiency guarantees for the amount of \$27.8 million provided to a private commercial bank as of June 30, 2003.

**(13) Subsequent Events**

On August 6, 2003, the Tourism Fund initiated foreclosure on the mortgage note it holds as collateral for the guarantee on the AFICA Cayo Largo bonds. The indenture of the AFICA Cayo Largo bonds requires the repayment of the bonds before the execution of the mortgage note. Therefore, in order to execute the mortgage note, the Tourism Fund obtained a line of credit from the Bank just prior to filing the foreclosure action, with which the Tourism Fund called the outstanding balance of the AFICA Cayo Largo bonds. Said bonds amounted to \$75.3 million. Management believes that the specific allowance that has been established for this project, which is included as part of the noncurrent portion of the allowance for losses on guarantees and letters of credit, is adequate.

**PUERTO RICO TOURISM DEVELOPMENT FUND**  
(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

June 30, 2003

Resulting from the above-mentioned foreclosure proceedings, several of the principals of the Cayo Largo Hotel development (Cayo Largo Resort Associates, Cayo Largo Hotel, and D. Group Equity Holdings) have counterclaimed by filing complaints for alleged damages and breach of contract by the Tourism Fund aggregating to approximately \$165 million. In addition, United States Fidelity and Guaranty Company (the insurer) has filed an action to obtain a declaration that it is not bound to perform under the performance and payment bond executed in connection with the construction and development of the project. All the counterclaims and other actions, the last of which was filed on February 11, 2004, are in early discovery stages.

On November 3, 2003, the Tourism Fund obtained a line of credit from the Bank for a maximum of \$155.3 million with the sole purpose of refinancing the AFICA Río Mar Associates bonds which the Tourism Fund guarantees. Said bonds were redeemed on December 22, 2003.

On December 31, 2003, the Tourism Fund refinanced the AFICA Hostal El Convento bonds, which the Tourism Fund guaranteed with a direct loan for the amount of \$9.9 million.

On January 22, 2004, the Tourism Fund obtained a line of credit from the Bank for a maximum of \$94.0 million with the sole purpose of lending said amount to International Hospitality Associates S en C por A, S.E. for the redevelopment of the Vanderbilt and La Concha Hotels.

On January 30, 2004, the Tourism Fund obtained a line of credit from the Bank for a maximum of \$28.0 million with the sole purpose of redeeming the AFICA Martineau Bay Resort bonds. On February 5, 2004, the Tourism Fund redeemed said bonds and on March 19, 2004, the Tourism Fund obtained ownership of the Martineau Bay Resort property. Currently, the Tourism Fund is evaluating the alternatives to sell the property to a third party. Management believes that the specific allowance that has been established for this project is adequate.

On June 30, 2004, the AFICA Hampton Inn Caguas bonds were paid in full. Consequently, the Tourism Fund's letter of credit for the amount of \$18.6 million for said project was cancelled.

**APPENDIX E**  
**FORM OF BOND COUNSEL OPINION**

September 10, 2004

Puerto Rico Industrial, Tourist, Educational,  
Medical and Environmental Control Facilities  
Financing Authority  
San Juan, Puerto Rico

Ladies and Gentlemen:

We have examined Act No. 121 of the Legislature of Puerto Rico, approved June 27, 1977, as amended (the "Act"), creating Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (the "Authority"), a body corporate and politic constituting a public corporation and governmental instrumentality of Puerto Rico.

We have also examined certified copies of the resolution of the Board of Directors of the Authority authorizing the execution and delivery of the Trust Agreement and the Loan Agreement hereinafter referred to, and certified copies of the proceedings and other proofs submitted relative to the authorization, issuance, and sale of the following bonds (the "2004 Bonds"):

***\$7,497,854.10***  
***Puerto Rico Industrial, Tourist, Educational, Medical***  
***and Environmental Control***  
***Facilities Financing Authority***  
***Tourism Revenue Bonds, 2004 Series A***  
***(Coco Beach Golf & Country Club Project)***

The 2004 Bonds are issued under and pursuant to a Deed of Trust Agreement dated September 28, 2000, as supplemented by that Supplemental Trust Agreement dated as of September 10, 2004 (collectively, the "Trust Agreement"), by and between the Authority and Banco Popular de Puerto Rico, San Juan, Puerto Rico, as trustee (the "Trustee"). All capitalized words and terms used

Puerto Rico Industrial, Tourist, Educational,  
Medical and Environmental Control Facilities  
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September 10, 2004  
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in this opinion letter and not otherwise defined herein will have the meanings ascribed to them in the Trust Agreement.

The proceeds of the sale of the 2004 Bonds are to be used to (i) pay a portion of the costs associated with the completion of the development, construction and equipping of two 18-hole championship golf courses, a clubhouse and related facilities in Río Grande, Puerto Rico and the costs of certain Improvements (as defined in the Loan Agreement); (ii) make a deposit to a debt service reserve fund as provided in the Trust Agreement; and (iii) pay certain expenses incurred in connection with the authorization and issuance of the 2004 Bonds.

Pursuant to a Loan Agreement, dated September 28, 2000, as supplemented by that Supplemental Loan Agreement dated as of September 10, 2004 (the "Loan Agreement"), with the Authority, Coco Beach Golf & Country Club, S.E. (the "Borrower") is obligated to make payments in installments sufficient to pay the principal of, premium, if any, and the interest on the Bonds as the same shall become due and payable. The Loan Agreement and the Trust Agreement provide that the installments shall be paid directly to the Trustee and shall be deposited to the credit of a special fund created by the Trust Agreement (the "Bond Fund"), which special fund is charged with the payment of the principal of, premium, if any, and interest on the 2004 Bonds and the bonds issued by the Authority under the Trust Agreement in 2000. The rights of the Authority under the Loan Agreement, except for certain reserved rights, has been pledged and assigned to the Trustee pursuant to the Trust Agreement.

In connection with the Borrower's obligation to make payments under the Loan Agreement, the Borrower has caused to be delivered to the Trustee an amended and restated irrevocable and unconditional stand-by letter of credit (the "Letter of Credit") issued by Puerto Rico Tourism Development Fund (the "Initial Letter of Credit Issuer"), under which the Trustee is permitted to make draws for the amounts required to pay the principal of and interest on the Bonds as provided in the Trust Agreement. The Trust Agreement requires the Trustee to make a claim under the Letter of Credit upon a failure by the Borrower to make the required payments under the Loan Agreement. To secure its obligations to the Authority and the Initial Letter of Credit Bank, the Borrower has executed and delivered certain Collateral Documents (as defined in the Contract of Purchase dated August 12, 2004 among the Authority, the Borrower and Santander Securities Corporation) for the benefit of the Authority and the Initial Letter of Credit Issuer.

The 2004 Bonds are subject to redemption as provided in the Trust Agreement.

Reference is made to the opinion of even date hereunder of McConnell Valdés, San Juan, Puerto Rico, counsel to the Borrower, with respect to, among other matters, the organization and good standing of the Borrower, the power of the Borrower to enter into and perform the Loan



Agreement and the Collateral Documents, the due authorization, execution and delivery of said agreements by the Borrower and as to the valid and binding nature and effect thereof with respect to the Borrower.

As to any questions of fact material to our opinion, we have relied upon representations of the Authority and the Borrower contained in the Trust Agreement and the Loan Agreement, upon the certified proceedings relative to the authorization, issuance and sale of the 2004 Bonds, and upon other certifications of the Authority and the Borrower (including certifications as to the use of 2004 Bond proceeds), without undertaking to verify the same by independent investigation. For purposes of this opinion, we assume that the Borrower will comply with all of its covenants in the Loan Agreement, particularly those dealing with source of income, and that the proceeds of the 2004 Bonds will be used in accordance with the provisions of the Trust Agreement and the Loan Agreement.

We have also examined the 2004 Bond as executed and authenticated.

From such examination, we are of the opinion that:

1. The Act is valid.
2. The proceedings of the Board of Directors of the Authority required in connection with the authorization, issuance and sale of the 2004 Bonds and the authorization, execution, and delivery of the Supplemental Loan Agreement, the Supplemental Trust Agreement and the Collateral Documents, as amended and/or restated on the date hereof, have been validly and legally taken.
3. The Trust Agreement, the Loan Agreement and the Collateral Documents have been duly authorized, executed and delivered by the Authority and assuming due authorization, execution and delivery by the other parties thereto, constitute the legal, valid, binding and enforceable obligations of the Authority in accordance with their terms, except to the extent such enforceability may be limited by bankruptcy, insolvency or other laws affecting creditors' rights generally, and subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).
4. The 2004 Bonds have been duly authorized by the Authority and constitute legal, valid and binding obligations of the Authority, payable solely from the Bond Fund and entitled to the benefit of the Trust Agreement.

5. All right, title and interest of the Authority in and to the Loan Agreement (except certain rights of the Authority including its rights to payment of expenses and indemnity) and the Security Agreements have been validly assigned to the Trustee.
6. The 2004 Bonds do not constitute an indebtedness of either Puerto Rico or any of its political subdivisions, other than the Authority, and neither Puerto Rico nor any of such political subdivisions, other than the Authority, will be liable thereon.
7. The 2004 Bonds, and the transfer of the 2004 Bonds, including any gain derived upon the sale of the 2004 Bonds, are exempt from Puerto Rico income tax pursuant to Article 8(b) of the Act.
8. Interest on the 2004 Bonds is (i) excluded from the gross income of the recipient thereof for Puerto Rico income tax purposes pursuant to Section 1022(b)(4)(B) of the Puerto Rico Internal Revenue Code of 1994, as amended (the "P.R. Code"); (ii) exempt from Puerto Rico income tax and alternative minimum tax pursuant to Section 1022(b)(4)(B) of the P.R. Code, Article 8(b) of the Act, and Section 3 of the Puerto Rican Federal Relations Act (the "PRFRA"); and (iii) exempt from Puerto Rico municipal license tax pursuant to Section 9(25) of the Puerto Rico Municipal License Tax Act of 1974, as amended, and Section 3 of the PRFRA.
9. The 2004 Bonds are exempt from Puerto Rico personal property tax pursuant to Section 3.11 of the Puerto Rico Municipal Property Tax Act of 1991, as amended, and Section 3 of the PRFRA.
10. The 2004 Bonds are exempt from Puerto Rico (i) gift tax with respect to donors who are residents of Puerto Rico at the time the gift is made and (ii) estate tax with respect to estates of decedents who are residents of Puerto Rico at the time of death, excluding United States citizens who acquired their United States citizenship other than by reason of birth or residence in Puerto Rico.
11. The 2004 Bonds will be considered an obligation of an instrumentality of Puerto Rico for purposes of (i) the non-recognition of gain rules of Section 1112(f)(2)(A) of the P.R. Code applicable to certain involuntary conversions and (ii) the exemption from the surtax imposed by Section 1102(g) of the P.R. Code available to corporations and partnerships that have a certain percentage of their net income invested in obligations of instrumentalities of Puerto Rico and certain other investments.

12. Interest on the 2004 Bonds is not excluded from the gross income of the recipient thereof for United States federal income tax purposes under Section 103(a) of the United States Internal Revenue Code of 1986, as amended (the "U.S. Code").
13. If (i) the Borrower is engaged in trade or business only in Puerto Rico during each taxable year when interest on the 2004 Bonds is paid or payable; (ii) such interest is not treated as paid by a trade or business conducted by the Borrower outside Puerto Rico, such determination to be made under Section 884(f)(1)(A) of the U.S. Code and the regulations thereunder; and (iii) for the three-year period ending with the close of the Borrower's taxable year immediately preceding the payment of interest on the 2004 Bonds the Borrower either (a) derived more than 20% of its gross income from sources within Puerto Rico, or (b) derived more than 20% of its gross income from the conduct of a trade or business in Puerto Rico, both determination to be made under Section 861(c)(1)(B) of the U.S. Code, then (a) in the case of an individual who is a *bona fide* resident of Puerto Rico during an entire taxable year, interest on the 2004 Bonds received by, or "original issue discount" (within the meaning of the U.S. Code and hereafter referred to as "OID") on the Bonds otherwise required to be recognized as gross income and accrued to, such individual during such taxable year, will constitute gross income from sources within Puerto Rico and therefore, is excludable from gross income for purposes of the U.S. Code pursuant to Section 933(1) thereof, and (b) interest on the 2004 Bonds derived by, or OID on the 2004 Bonds otherwise required to be recognized as gross income and accrued to, a corporation organized under the laws of Puerto Rico or any other foreign country, as determined for purposes of the U.S. Code ("foreign corporations"), is not subject to a taxation under the Code, provided that (x) such foreign corporation is not a foreign personal holding company, a controlled foreign corporation or a passive foreign investment company under the U.S. Code, (y) such foreign corporation is not treated as a domestic corporation for purposes of the U.S. Code and (z) interest on the 2004 Bonds and OID is not effectively connected with the conduct of a trade or business in the United States by such foreign corporation.

United States taxpayers, other than individuals who are bona fide residents of Puerto Rico during the entire taxable year, will be subject to United States federal income tax on gain realized upon the sale or exchange of the 2004 Bonds. Pursuant to Notice 89-40, 1989-1 CB 681, gain on the sale of the 2004 Bonds (not including original issue discount accruing under the U.S. Code as of the date of such sale or exchange) by an individual who is a bona fide resident of Puerto Rico for purposes of Section 865(g)(1) of the U.S. Code will constitute income from sources within Puerto Rico and will qualify for the exclusion provided in Section 933(1) of the U.S. Code, provided that the 2004 Bonds do not constitute inventory property in such individual's hands.

Puerto Rico Industrial, Tourist, Educational,  
Medical and Environmental Control Facilities  
Financing Authority  
September 10, 2004  
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The P.R. Code does not provide rules with respect to the treatment of the excess of the amount due at maturity of a 2004 Bond over its initial offering price ("original issue discount"). Under current administrative practice followed by the Puerto Rico Treasury Department, original issue discount is treated as interest.

Ownership of the 2004 Bonds may result in having a portion of the interest expense allocable to interest or original issue discount on the 2004 Bonds disallowed for purposes of computing the regular tax and the alternative minimum tax for Puerto Rico income tax purposes.

This opinion is limited to the above, and we express no other opinion regarding Puerto Rico or United States tax consequences arising from ownership or disposition of the 2004 Bonds.

This letter is furnished by us solely for the benefit of the Authority and the holders from time to time of the 2004 Bonds and may not be relied upon by any other person.

Respectfully submitted,

No dealer, salesperson or other person is authorized to give any information or to make any representation not contained or incorporated by reference in this official statement and, if given or made, such information or representation must not be relied upon as having been authorized by the Authority, the Borrower or TDF. This official statement does not constitute an offer to sell or the solicitation of an offer to buy the Bonds offered hereby in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction. Neither the delivery of this official statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of the Authority, the Borrower or TDF since the date hereof or that the other information contained herein is correct as of any time subsequent to the date hereof.

**\$7,497,854.10**

**AFICA  
TOURISM REVENUE BONDS,  
2004 SERIES A**

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**(COCO BEACH GOLF & COUNTRY  
CLUB PROJECT)**

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**OFFICIAL STATEMENT**

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