



May 29, 2013

Statement by the Government Development Bank for Puerto Rico

Puerto Rico Highways and Transportation Authority \$139,875,000 Grant Anticipation Revenue Bonds (Series 2004)

A scheduled payment of grant proceeds due in March 2013 to the Puerto Rico Highways and Transportation Authority (the "Authority") under certain grant agreements (the "Federal Grant Agreements") with the Federal Highway Administration ("FHWA") was withheld by the United States Department of the Treasury (the "US Treasury") to setoff payments due on a debt owed by the Commonwealth of Puerto Rico (the "Commonwealth") to the United States Army Corps of Engineers ("USACE") in connection with the completion of the Cerrillos Dam and Reservoir and the Portuguese-River and Bucana-River Projects (the "Reservoir Projects").

The grant proceeds are pledged to the payment of principal and interest on the Authority's Grant Anticipation Revenue Bonds (Series 2004) (the "Bonds") issued by the Authority pursuant to Resolution No. 04-18 adopted by the Authority on April 7, 2004 (the "GARVEE Resolution"). On March 15, 2013, a debt service payment due for the Bonds, the required \$2,066,813.75 interest payment was not made on a timely basis because sufficient grant proceeds were not on deposit in the Bond Payment Fund on such date due. The insufficiency was caused by grant proceeds being setoff against Commonwealth debt associated with the Reservoir Projects. Sufficient funds were available on that date in the Debt Service Reserve Fund to pay the required interest payment in full. The Bank of New York Mellon paid the interest payment in full on March 19, 2013 (two business days after the payment was due) from excess earnings on deposit in the Debt Service Reserve Fund and a draw on the Debt Service Reserve Fund in the amount of \$231,236.66. In order to maintain the Debt Service Reserve Fund at the applicable requirement therefore, the Authority transferred excess investment earnings on deposit in the Construction Fund in the amount of \$231,236.66 to the Debt Service Reserve Fund. Such transfer was made in accordance the requirements of the GARVEE Resolution. As of today, the Debt Service Reserve Fund continues to be fully funded at the amount required by the GARVEE Resolution.

Neither the Authority nor the Commonwealth received advance notice that the grant proceeds would be setoff against the Commonwealth debt. When the grant proceeds were not received when due, the Authority initially believed that the grant payment was incorrectly made to the wrong account and that FHWA would be correcting the error and transferring such payment to the Authority. In subsequent conversations between the Authority and FHWA, the Authority learned that the payment was not made because such funds, along with other federal funds due to the Commonwealth and/or its instrumentalities, were being setoff for the Commonwealth debt associated with the Reservoir Projects. In April 2011, the Commonwealth had received a notification from USACE establishing an allocation of costs and repayment schedule for its allocated share of the construction costs of the Reservoir Projects amounting to \$214 million. According to the USACE's notification, the allocated share of the construction costs plus accrued and projected interest calculated at a per annum rate of 6.063% through maturity (June 30, 2046) totaled approximately \$598 million, as of April 2011. Due to non-payment by the Commonwealth of amounts deemed due by USACE, USACE notified the Commonwealth in late 2012 of its intention to refer the Commonwealth to the US Treasury for collection pursuant to the Treasury Offset Program ("TOP") of any amounts due, but did not identify which federal funds would be withheld. As of May 15, 2013, the US Treasury had withheld approximately \$158 million in federal funds, including amounts due to the Authority under the Federal Grant Agreements, pursuant to the TOP. The Commonwealth expects that these amounts will be applied by the US Treasury against the principal and interest

owed by the Commonwealth to USACE and therefore shall not be returned to the Commonwealth as part of any final debt agreement.

The USACE informed the Commonwealth on May 16, 2013 that it had decided to take the Commonwealth off the TOP pending the negotiation of the final debt agreement with the Commonwealth. The Secretary of the Treasury of the Commonwealth is in the process of negotiating a final debt agreement with the USACE and the United States Department of Justice to achieve more manageable repayment terms and to avoid further offsets of federal payments due to the Commonwealth and/or its instrumentalities. As part of such negotiations, the Commonwealth has requested that certain amounts constituting penalty interest be forgiven.

On May 29, 2014 Moody's placed the Bonds on review for possible downgrade due to the notice that a draw on the debt service reserve fund was made after federal highway grant payments pledged to the Bonds were withheld by the US Treasury. The Authority and the Government Development Bank for Puerto Rico are in discussions with the Trustee to develop a plan that would avoid future late payments of debt service on the Bonds.

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