



GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and
Required Supplementary Information

June 30, 2013

(With Independent Auditors' Report Thereon)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Table of Contents

	Page(s)
Independent Auditors' Report	1-2
Management's Discussion and Analysis (Unaudited)	3-17
Basic Financial Statements as of and for the year ended June 30, 2013:	
Government-wide Financial Statements:	
Statement of Net Position	18
Statement of Activities	19
Fund Financial Statements:	
Balance Sheet – Governmental Funds	20
Statement of Revenues, Expenses and Changes in Fund Balance (Deficit) – Governmental Funds	21
Balance Sheet – Proprietary Funds	22-23
Statement of Revenues, Expenses and Changes in Net Position (Deficit) – Proprietary Funds	24
Statement of Cash Flows – Proprietary Funds	25-28
Notes to Basic Financial Statements	29-92



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

Independent Auditors' Report

The Board of Directors
Government Development Bank for Puerto Rico:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Government Development Bank for Puerto Rico (the Bank), a component unit of the Commonwealth of Puerto Rico (the Commonwealth), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Bank's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.



Opinions

In our opinion, the financial statements referred to above present fairly in all material respects, the respective financial position of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of Government Development Bank for Puerto Rico, as of June 30, 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of a Matter

As discussed in note 7 to the financial statements, loans to the Commonwealth and its public entities amounted to approximately \$6.9 billion or 48% of the Bank's total assets as of June 30, 2013. These loans are expected to be collected through appropriations from, bond issuances of, and revenues generated by the Commonwealth and its public entities. As discussed in note 4 to the financial statements, the Bank's liquidity and financial condition depends on the repayment of loans made to the Commonwealth and its public entities which face significant fiscal and financial challenges in their ability to generate sufficient funds from taxes, charges and/or future bond issuances.

Other Matters

Restatement of Net Position and Fund Balance

As part of our audit of the 2013 basic financial statements we also audited the adjustments described in note 2 that were applied to restate net position (deficit) and fund balance (deficit) as of July 1, 2012. The Bank's previously issued basic financial statements were audited by other auditors. In our opinion, such adjustments are appropriate and have been properly applied.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 17 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

San Juan, Puerto Rico
April 11, 2014

Stamp No. E100998 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

This section presents a narrative overview and analysis of the financial performance of Government Development Bank for Puerto Rico (the Bank or GDB) as of and for the year ended June 30, 2013. The information presented here should be read in conjunction with the basic financial statements, including the notes thereto.

Financial Highlights

- During 2013, the Puerto Rico Housing Finance Authority identified prior period errors in the accounts payable and accrued liabilities of an understatement of approximately \$20 million. Accounts payable and accrued liabilities in the governmental activities were understated by \$20,427,338 related to disallowed costs of the HOME Program claimed by HUD. Such claim existed in prior year, but was not recognized. See notes 2 and 19 for additional information. Accounts payable and accrued liabilities of the New Secure Housing Program fund (presented as a nonmajor governmental fund) were overstated by \$524,672. The accrual was based on a board resolution committing the funds for future events. The 2012 financial information included in the management discussion and analysis has been adjusted to reflect this correction.
- Total assets government-wide at June 30, 2013 amounted to \$14,326 million for a decrease of \$1,454 million or 9.2% from the \$15,780 million at June 30, 2012. Liabilities decreased by 11% or \$1,332 million to \$11,947 million from \$13,279 million.
- Net position government-wide decreased from \$2,501 million at June 30, 2012 to \$2,379 million at June 30, 2013. The decrease in net position of \$122 million in fiscal year 2013 is composed of a negative change in net position of approximately \$60 million from business-type activities and a negative change in net position of approximately \$62 million from governmental activities. The ratio of net position to total assets increased to 16.6% at June 30, 2013 from 15.8% at June 30, 2012.
- The operating income of the GDB Operating Fund decreased from \$285.5 million in 2012 to \$178.9 million or \$106.6 million in fiscal year 2013.
- Interest income on loans in the GDB Operating Fund amounted to \$506.2 million in 2013, an increase of \$18.3 million over the prior year. The Bank collected approximately \$34.9 million of principal and \$190.6 million of interest on loans to the public sector from the general fund of the Commonwealth of Puerto Rico (the Commonwealth).
- Included within salaries and fringe benefits expense is approximately \$4.3 million related to an employees' voluntary termination plan provided during the current fiscal year under Act No. 70 of July 2, 2010.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

Overview of the Financial Statements

This discussion and analysis is required supplementary information to the basic financial statements and is intended to serve as introduction to the basic financial statements of the Bank. The basic financial statements comprise three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements.

(a) Government-Wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Bank's finances, in a manner similar to a private-sector business. The statement of net position provides information on the Bank's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Bank is improving or deteriorating. The statement of activities presents information on how the Bank's net position changed during the reporting period. Changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

(b) Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Bank's funds are divided in two categories: governmental funds and proprietary funds.

- *Governmental Funds* – Governmental funds are used to account for the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable resources, as well as balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of financial decisions related to the Bank's governmental activities. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

- *Proprietary Funds* – Proprietary funds provide the same type of information as the business-type activities in the government-wide financial statements, only in more detail. The proprietary fund financial statements of the Bank provide separate information on the business-type activities of the Bank's blended component units.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

(c) *Notes to the Basic Financial Statements*

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide financial statements and the fund financial statements.

Government-Wide Financial Analysis

Total assets and total liabilities of the Bank at June 30, 2013, amounted to \$14,326 million and \$11,947 million, respectively, for net position of \$2,379 million or 16.6% of total assets. Within assets, investments and investment contracts and deposits placed with banks show the most significant decline of \$2.4 billion and \$428 million, respectively, over fiscal year 2012 ending balances. The proportion of investments and investment contracts to total assets decreased to 21% in 2013 from 34.1% in 2012.

The loan portfolio of \$9,635 million at June 30, 2013, shows an increase of 15% when compared to the prior year ending balance of \$8,374 million. Loans as a percentage of total assets increased 14.1% from 53.1% at the end of fiscal year 2012 to 67.2% at June 30, 2013.

Out of the \$2,379 million in net position, \$2,102 million or 88.3% is unrestricted, \$56 million or 2.4% is restricted for use in housing programs, \$66.1 million or 2.8% for debt service, \$89 million or 3.8% is invested in capital assets and \$65 million or 2.7% is restricted for the mortgage loan insurance program. Governmental and business-type activities are discussed separately in the following subsections.

(a) *Governmental Activities*

Total assets of governmental activities amounted to \$89.6 million at June 30, 2013. Total liabilities amounted to \$216.8 million, for a net position (deficit) of \$127.2 million. Net position (deficit) has been broken down into amounts restricted for affordable housing programs of \$20 million, and the unrestricted component of net position (deficit) of approximately \$147.2 million, which means that the restriction on the use of available assets will not allow the Bank to satisfy its existing liabilities from those assets, and therefore that it will depend on future appropriations for the repayment of part of its obligations.

Condensed financial information on assets, liabilities and net position (deficit) of governmental activities as of June 30, 2013 and 2012 is shown below (amounts in thousands):

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

	June 30		Change	
	2013	2012	Amount	Percent
Assets:	(As restated)			
Cash and due from banks, and deposits placed with banks	\$ 16,143	26,281	(10,138)	(38.6)%
Investments and investment contracts	62,027	63,844	(1,817)	(2.8)
Other assets	11,401	13,826	(2,425)	(17.5)
Total assets	<u>\$ 89,571</u>	<u>103,951</u>	<u>(14,380)</u>	<u>(13.8)%</u>
Liabilities:				
Accounts payable and accrued liabilities	\$ 36,989	64,084	(27,095)	(42.3)%
Notes payable – due in more than one year	3,431	3,427	4	0.1
Total liabilities before internal balances	40,420	67,511	(27,091)	(40.1)
Internal balances	176,372	102,062	74,310	72.8
Total liabilities	<u>\$ 216,792</u>	<u>169,573</u>	<u>47,219</u>	<u>27.8%</u>
Net position (deficit):				
Investment in capital assets	\$ 5	19	(14)	(73.7)%
Restricted for affordable housing programs	20,009	39,512	(19,503)	(49.4)
Unrestricted position (deficit)	(147,235)	(105,153)	(42,082)	40.0
Total net position (deficit)	<u>\$ (127,221)</u>	<u>(65,622)</u>	<u>(61,599)</u>	<u>93.9%</u>

Restricted investments and investment contracts amounted to \$62.0 million and, together with restricted cash and due from banks and deposits placed with banks of \$16.1 million, account for the majority of the assets held by governmental activities. These assets are held to provide funds for the execution of the various affordable and other housing programs managed by the Housing Finance Authority. Other assets are mainly restricted and are composed principally of amounts due from the HUD and HOME federal programs. Accrued liabilities mainly consist of unpaid expenditures related to the HOME Program fund and of subsidies payable on various housing programs.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

Condensed financial information on expenses, program revenues and changes in net position (deficit) of governmental activities during the years ended June 30, 2013 and 2012 is shown below (in thousands):

	Year ended June 30, 2013		
	General government	Housing assistance programs	Total
Expenses	\$ 6,884	230,365	237,249
Program revenues:			
Charges for services – financing and investment	—	3,923	3,923
Operating grants and contributions	—	170,501	170,501
Net expenses	<u>\$ (6,884)</u>	<u>(55,941)</u>	<u>(62,825)</u>
Transfers-in			1,226
Change in net position (deficit)			(61,599)
Net position (deficit) – beginning of year			<u>(65,622)</u>
Net position (deficit) – end of year			<u>\$ (127,221)</u>

	Year ended June 30, 2012 (As restated)		
	General government	Housing assistance programs	Total
Expenses	\$ 8,260	264,927	273,187
Program revenues:			
Charges for services – financing and investment	—	4,683	4,683
Operating grants and contributions	—	177,001	177,001
Net expenses	<u>\$ (8,260)</u>	<u>(83,243)</u>	<u>(91,503)</u>
Transfers-in			81,914
Change in net position (deficit)			(9,589)
Net position (deficit) – beginning of year (as restated)			<u>(56,033)</u>
Net position (deficit) – end of year			<u>\$ (65,622)</u>

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

Governmental Fund Results

Operating grants and contributions decreased by \$6 million when compared to the prior year. Operating grants and contributions decreased from \$177 million in 2012 to \$171 million in 2013 mainly due to the net effect of the decline in American Recovery and Reinvestment Act (ARRA) funds of \$21 million, offset by an increase of \$7 million on the operating grants of the HUD programs and \$6.6 million on the operating grants of the HOME program.

The loss in the operations of the governmental funds is mainly related to the fact that the Housing Finance Authority is subsidizing certain housing assistance programs with internally generated funds. During 2013, the change in net position (deficit) of the governmental activities increased by \$52 million from \$9.6 million during the year ended in June 30, 2012, to \$61.6 million during the year ended June 30, 2013. Significant increase is mainly related to a reduction of \$80.7 million and \$7.3 million in the amounts transferred from the Housing Finance Authority proprietary funds to the governmental funds and program revenues, respectively, which were offset by an increase in operating expenses of the Home Assistance Programs of approximately \$55 million and a reduction in expenses in General Government of \$1.4 million.

Following is an analysis of the financial position and results of operations of the Bank's major governmental funds:

(a) *HUD Programs*

This fund accounts for the U.S. Housing Act Section 8 programs administered by the Housing Finance Authority under the authorization of the U.S. Department of Housing and Urban Development (HUD). Presently, the Housing Finance Authority operates three programs whereby low-income families receive directly or indirectly subsidies to pay for their rent. The housing vouchers program enables families to obtain rental housing in a neighborhood of their choice. The other programs are project-based subsidies whereby housing developers are given incentives to keep their properties available for certain markets. The expenditures of the HUD programs increased \$7 million from \$134 million in 2012 to \$141 million in 2013.

(b) *HOME Program*

This fund accounts for funds received from HUD for the administration of the HOME Program. The main purpose of this program is to increase the supply of decent and affordable housing for low and very low income families. The expenditures of the HOME Program amounted to \$26 million for the fiscal year ended June 30, 2013, an increase of \$9 million over the expenditures of the previous fiscal year.

(c) *Affordable Housing Mortgage Subsidy Programs*

Affordable Housing Mortgage Subsidy Programs (AHMSP) Act No. 124 – This special revenue fund is used to account for the proceeds of specific revenue sources under different stages of the AHMSP that are legally restricted for expenditures to promote the origination of mortgage loans by financial institutions in the private sector to low and moderate income families. Under this program, the Authority commits to provide a subsidy for the down payment and/or the principal and interest

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

payments on mortgage loans originated under a predetermined schedule of originations. Loans originated, as well as servicing, are kept by the originating financial institution. There was no open schedule of originations under this program as of June 30, 2013. Program and debt expenditures for the year ended June 30, 2013, amounted to approximately \$20.6 million.

(d) My New Home Program

This program provides closing costs assistance to eligible families for the purchase of a principal residence through reimbursements of origination and closing costs. Subsidy and interest expenditures decreased by \$20.2 million when compared with prior year. Subsidy and interest expenditures decreased from \$69.2 million in 2012 to \$49 million in 2013, mainly due to increase of underwriting requirements noted in the banking industry and termination of the available benefits to eligible families.

At June 30, 2013, the Housing Finance Authority had various governmental funds in a deficit position. The Housing Finance Authority expects to cover these deficits through contributions from the Commonwealth. Refer to note 22 to the basic financial statements for additional information on these funds.

Business-Type Activities

Condensed financial information on assets, liabilities and net position as of June 30, 2013 and 2012, is presented below (in thousands):

	June 30		Change	
	2013	2012	Amount	Percent
Assets:				
Cash and due from banks	\$ 65,017	70,962	(5,945)	(8.4)%
Federal funds sold and securities purchased under agreements to resell	450,000	477,900	(27,900)	(5.8)
Deposits placed with banks	554,507	977,406	(422,899)	(43.3)
Investments and investment contracts	2,953,531	5,319,171	(2,365,640)	(44.5)
Loans receivable – net	9,635,090	8,374,104	1,260,986	15.1
Accrued interest receivable	275,001	134,623	140,378	104.3
Real estate available for sale	65,595	107,824	(42,229)	(39.2)
Other receivable	102,734	75,866	26,868	35.4
Other assets	35,294	41,747	(6,453)	(15.5)
Internal balances	176,372	102,062	74,310	72.8
Capital assets	99,923	96,199	3,724	3.9
Total assets	\$ 14,413,064	15,777,864	(1,364,800)	(8.7)%

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

	<u>June 30</u>		<u>Change</u>	
	<u>2013</u>	<u>2012</u>	<u>Amount</u>	<u>Percent</u>
Liabilities:				
Deposits:				
Demand	\$ 3,087,710	3,947,130	(859,420)	(21.8)%
Certificates of deposit	2,488,960	2,119,804	369,156	17.4
Securities sold under				
agreements to repurchase	634,301	884,484	(250,183)	(28.3)
Accrued interest payable	48,952	48,847	105	0.2
Accounts payable, accrued				
liabilities, and other liabilities	359,651	277,658	81,993	29.5
Bonds, notes, and mortgage-				
backed certificates payable:				
Due in one year	424,743	603,528	(178,785)	(29.6)
Due in more than one year	4,862,220	5,329,396	(467,176)	(8.8)
Total liabilities	<u>\$ 11,906,537</u>	<u>13,210,847</u>	<u>(1,304,310)</u>	<u>(9.9)%</u>
Net position:				
Net investment in capital assets	\$ 89,609	96,199	(6,590)	(6.9)%
Restricted for:				
Mortgage loan insurance	64,954	62,762	2,192	3.5
Affordable housing programs	35,941	91,492	(55,551)	(60.7)
Debt service	66,114	—	66,114	100.0
Other housing programs	693	3,025	(2,332)	(77.1)
Unrestricted net position	<u>2,249,216</u>	<u>2,313,386</u>	<u>(64,170)</u>	<u>(2.8)</u>
Total net position	<u>\$ 2,506,527</u>	<u>2,566,864</u>	<u>(60,337)</u>	<u>(2.4)%</u>

(a) Federal Funds Sold and Securities Purchased Under Agreements to Resell and Deposits Placed with Banks

The Bank decreased its federal funds sold and securities purchased under agreements to resell by \$28 million, from \$478 million at June 30, 2012, to \$450 million at June 30, 2013. Deposits placed with banks decreased by \$423 million, from \$977 million to \$554 million.

(b) Investments and Investment Contracts

Investments and investment contracts held in business-type activities amounted to \$2,954 million at June 30, 2013. This amount represents a decrease of \$2,366 million or 44.5% when compared to the prior year balance of \$5,319 million. The investment portfolio has consisted primarily of U.S. Treasury Notes and U.S. sponsored agency notes and mortgage-backed securities with very high credit ratings, reflecting the Bank's prudent and conservative investment policies. The majority of the Bank's investment portfolio is invested in AAA to A – rated securities. The investment portfolio comprised 20.5% of the total assets of the Bank's business-type activities at June 30, 2013, down by 13.3% as compared to 33.7% at the close of fiscal year 2012. Within the investment securities portfolio, \$925.6 million at June 30, 2013 and \$1,367 million at June 30, 2012, were restricted or pledged as collateral or payment source for specific borrowings.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

(c) *Loans Receivable*

Net loans receivable increased by \$1,261 million or 15.1%, from the \$8,374 million balance at June 30, 2012, to \$9,635 million at June 30, 2013. The Bank's basic role is to provide financing support to the Commonwealth and its public entities and municipalities and other operational needs. To support the governmental efforts of improving and stimulating the Island's economy, the Bank also finances the development and construction of infrastructure, housing projects and hotels.

Loans to municipalities had a net increase of \$67.4 million over the prior year balance. Some of these loans were possible with the improvement of the municipalities' debt margin capacity as a result of increases in the property and municipal sales taxes pledged for the repayment of the loans.

As further explained in notes 4 and 7 (b) to the accompanying basic financial statements, management believes the inherent credit risk of its public entities and municipalities loan portfolios is low as evidenced by the minimal historical losses incurred along with other mitigating factors, including the ability of the Commonwealth to enact laws and ultimately provide for a definitive repayment source and to the fact that the Director of the Puerto Rico Office of Management and Budget ("OMB") has included in the budget of the Commonwealth appropriations to assist the Commonwealth and certain of its public entities and municipalities requiring financial support in repaying their loans with the Bank. The Legislature has historically approved these appropriations, and such practice is anticipated to continue in the future. In addition, management's estimate of the allowance for loan losses is based on the fact that the Bank has been able to collect most of the loans to such public and municipalities sectors with proceeds from bonds or notes issued by the Commonwealth or its public entities, including bonds issued by the Puerto Rico Sales Tax Financing Corporation (the "Sales Tax Corporation" or "COFINA" by its Spanish acronym), a component unit of the Commonwealth. The Commonwealth and its public entities have never defaulted on their respective bonds. The Bank has, in the past, collected the outstanding principal and interest at the contractual rate on loans repaid from the Commonwealth's appropriations, or bond or note proceeds.

Private sector loans outstanding at June 30, 2013 and 2012 amounted to \$537 million and \$533 million, respectively, net of an allowance for loan losses and deferred origination fees of \$233.6 million and \$26.4 million at June 30, 2013 and \$290.1 million and \$27.5 million at June 30, 2012, respectively. Private sector loans mainly include loan facilities for the housing and tourism sectors through some component units of the Bank. Refer to note 7 to the basic financial statements for further information on loans receivable and allowance for loan losses.

(d) *Real Estate Available for Sale and Other Receivables*

Real estate available for sale includes several properties received in fiscal year 2009 in lieu of payment of a loan whose principal balance and accrued interest receivable amounted to \$144.2 million at December 30, 2008. As part of such agreement any subsequent loss or reduction of fair value shall be repaid by the Commonwealth or one of its components units. As of June 30, 2013, management of the Bank maintains approximately \$82.3 million of other receivable balance, net of repayments, related to the losses or reductions in fair value from such properties.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

For the fiscal year 2014, the Office of Management and Budget of the Commonwealth (OMB) has committed to include in the Commonwealth general fund budget an amount of approximately \$7.5 million to repay a portion of the receivables. Future appropriations will be subject to the approval of the Legislature of the Commonwealth (the Legislature).

(e) Capital Assets

Capital assets, net of accumulated depreciation and amortization, amounted to \$99.9 million at June 30, 2013, an increase of \$3.7 million from the prior year. Additions to capital assets during the year ended June 30, 2013 aggregated to \$14.7 million principally in the land and other nondepreciable assets line item. Depreciation and amortization of \$2.1 million was charged to operations during fiscal year 2013. Refer to note 10 to the basic financial statements for additional information on capital assets.

(f) Deposits

Deposits mainly consist of interest-bearing demand deposit accounts, special government deposit accounts, and time deposits from the Commonwealth, its public entities and municipalities.

Demand deposits and certificates of deposit had a combined decrease of \$490 million, from \$6,067 million at June 30, 2012 to \$5,577 million at June 30, 2013. Deposits represent approximately 45.9% and 46.8% of total liabilities at June 30, 2013 and 2012, respectively.

(g) Securities Sold under Agreement to Repurchase

Securities sold under agreements to repurchase decreased by \$250.2 million or 28.3% from \$885 million to \$634 million at June 30, 2012 and June 30, 2013, respectively.

(h) Long-Term Debt

The Bank and the Housing Finance Authority redeemed several notes and bonds payable during fiscal year 2013, which explains the net decrease of \$646 million or 10.8% over the prior year balance of \$5,933 million. Gross debt originations and payments during the fiscal year ending June 30, 2013, amount to \$554 thousand and \$1.2 million, respectively.

The credit ratings of the Commonwealth and most of its public entities (including the Bank) were downgraded to noninvestment grade categories. With respect to the Bank, Moody's Investors Service lowered its credit rating to "Ba2" and maintained its negative outlook, while Standard & Poors Rating Services lowered its credit rating to "BB" and maintained it in "CreditWatch" with negative implications.

Condensed financial information on expenses, program revenues and changes in net position for business-type activities for the years ended June 30, 2013 and 2012 is presented below (in thousands):

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

<u>Activity</u>	<u>Year ended June 30, 2013</u>			
	<u>Expenses</u>	<u>Program revenues</u>		<u>Net revenues/ (expenses)</u>
		<u>Charges for services</u>		
		<u>Fees, commissions, and others</u>	<u>Financing and investment</u>	
GDB Operating Fund	\$ 361,896	15,059	510,518	163,681
Housing Finance Authority	48,032	12,450	30,914	(4,668)
Tourism Development Fund	196,555	4,734	(6,408)	(198,229)
Public Finance Corporation	4	—	1	(3)
Capital Fund	34	14	—	(20)
Development Fund	20,179	101	331	(19,747)
Other nonmajor funds	127	—	2	(125)
Total	\$ 626,827	32,358	535,358	(59,111)
Transfers to governmental activities				(1,226)
Change in net position				(60,337)
Net position – beginning of year				2,566,864
Net position – end of year				\$ 2,506,527

<u>Activity</u>	<u>Year ended June 30, 2012</u>			
	<u>Expenses</u>	<u>Program revenues</u>		<u>Net revenues/ (expenses)</u>
		<u>Charges for services</u>		
		<u>Fees, commissions, and others</u>	<u>Financing and investment</u>	
GDB Operating Fund	\$ 402,188	36,827	638,403	273,042
Housing Finance Authority	98,865	16,758	60,903	(21,204)
Tourism Development Fund	238,885	3,224	14,898	(220,763)
Public Finance Corporation	4	153	1	150
Capital Fund	38	—	—	(38)
Development Fund	2,355	—	304	(2,051)
Other nonmajor funds	109	—	3	(106)
Total	\$ 742,444	56,962	714,512	29,030
Transfers to governmental activities				(81,914)
Change in net position				(52,884)
Net position – beginning of year				2,619,748
Net position – end of year				\$ 2,566,864

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

Activities presented in the statement of activities coincide with the major proprietary funds of the Bank. During the fiscal year 2013, GDB Operating Fund generated financing and investment revenues of \$511 million from its loan and investment portfolios, and \$15 million in other charges for services, including its fiscal agency function. These revenues covered \$391 million in expenses, including \$28.8 million in transfers to a component unit, for a change in net position, of \$135 million, surpassing the change in net position of any other activity.

Proprietary Funds

Following is a brief discussion of the most significant changes in the Bank's proprietary funds, not previously discussed. Our main focus will be on GDB Operating Fund, since separate basic financial statements are issued for Housing Finance Authority, Tourism Development Fund and Public Finance Corporation, which are blended component units.

(a) GDB Operating Fund

Total assets of the GDB Operating Fund amounted to \$13,720 million at June 30, 2013, compared to \$14,957 million at June 30, 2012. This represents a decrease of \$1,237 million, which was sustained by the net decrease in liabilities of \$1,372 million and an increase change in net position of \$135 million. The investment portfolio decreased by \$2,139 million and loans increased by \$1,211 million. Cash and due from banks and accrued interest receivable increased from \$209 million at June 30, 2012 to \$343 million at June 30, 2013.

Operating income of the GDB Operating Fund experienced a decrease from \$285 million in fiscal year 2012 to \$179 million in fiscal year 2013, or \$106 million, which represents a 37% decrease. Change in net position had a significant decrease from \$274 million in fiscal year 2012 to \$135 million in fiscal year 2013. Following is a discussion of the various components of the change in net position of the GDB Operating Fund, compared to the prior year:

(i) Interest Income, Interest Expense and Change in Fair Value of Investments

Net investment income, the difference between interest income (loans and investments) and interest expense, decreased \$77 million or 25.3%, from \$304 million in 2012 to \$224 million in 2013. Most of the decrease results from the income driven from the investment portfolio, which shows a decrease of \$146 million or 97% when compared to the prior year results. Change in fair value of investments contributed to the decrease with a loss of \$66 million, which is \$127 million less than the gain of \$61 million of fiscal year 2012. Interest and dividend income on investments decreased \$22.4 million or 26.1%. Interest income on loans in the GDB Operating Fund amounted to \$506.2 in 2013, an increase of \$21.3 million over the prior year. Interest expense decreased by \$47 million, or 14%, mainly due to the redemption of GDB Senior Notes payable of approximately \$319.5 million during the year.

(ii) Noninterest Income

Noninterest income decreased to \$15 million in fiscal year 2013 from \$37 million in fiscal year 2012, or \$22 million. Fiscal agency fees constitute the main component of noninterest income. Bond issuances activity of public sector entities decreased during fiscal year 2013

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

when compared to fiscal year 2012. The fiscal agency fees decreased from \$25 million in fiscal year 2012 to \$2 million in fiscal year 2013, representing a decrease of 92%.

(iii) Noninterest Expenses

Total noninterest expenses showed an increase of \$4 million from \$55 million in fiscal year 2012 to \$59 million in fiscal year 2013. The increase is mainly due to the net effect of: (1) other expenses decreased by \$8.5 million in fiscal year 2013, (2) \$11.5 million increase in professional services, (3) increases of approximately \$600,000 in salaries and fringe benefits, and (4) \$332,000 in occupancy and equipment costs.

(b) *Housing Finance Authority*

Net position of the Housing Finance Authority decreased by \$6 million from \$540 million at June 30, 2012 to \$534 million at June 30, 2013 as a result of decrease in total assets and liabilities of \$119 million and \$113 million, respectively. The decrease in total assets is mainly due to the following:

- Cash decreased from \$19 million at June 30, 2012 to \$2.6 million at June 30, 2013 or a \$16.4 million decrease as a result of housing program disbursements.
- Investments and deposits placed with banks decreased from \$607 million at June 30, 2012 to \$524 million at June 30, 2013 or an \$83 million decrease. This decrease was principally the result of investment redemptions and sales to originate construction and single-family loans and for liquidity purposes.
- Loans receivable, net, increased to \$296 million at June 30, 2013 from \$290 million in 2012 or a \$6 million increase.
- Assets, excluding cash, deposits placed with banks, loans, and investments, decreased from \$53 million at June 30, 2012 to \$26 million at June 30, 2013 or a \$27 million decrease. There was a decrease in balances due from governmental funds of approximately \$26 million.
- The decrease in long-term liabilities of approximately \$79.7 million is the net effect of the redemption of approximately \$229 million of Special Obligation notes netted by issuance of Special Obligation Notes of approximately \$152 million.
- Negative change in net position decreased from \$105 million in 2012 to \$6 million in 2013, or a loss reduction of \$99 million. The main items that contributed to this decrease was a reduction on net transfers of \$82 million, the reduction on interest expense of approximately \$9 million and a reduction of \$7 million on other noninterest expenses.

(c) *Tourism Development Fund*

Total assets decreased to \$376 million from \$481 million in 2012 or a decrease of \$105 million. The Tourism Development Fund mostly finances its loan portfolio through credit facilities obtained from the Bank. Notes payable due to the Bank at year-end were \$332 million for a decrease of \$75 million from June 30, 2012. The Tourism Development Fund originated approximately \$35.1 million in loans to the private sector during the year ended June 30, 2013. These loans are principally

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

collateralized by real estate property to minimize the credit risk. The analysis of the allowance for loan losses required an incremental adjustment of \$23.8 million during the year ended June 30, 2013.

At June 30, 2013, outstanding guarantees and letters of credit of the Tourism Development Fund amounted to \$553.1 million. Also, the exposure assessment required an increase of the allowance for possible losses on guarantees and letters of credit of \$156 million.

Change in net position of the Tourism Development Fund went from a \$220.8 million loss recorded last year to a loss of \$169.4 million in 2013. Loss during the year is principally due to the increase in the allowance for loan losses and allowance for guarantees and letter of credits recorded during the year.

At June 30, 2013, the Tourism Development Fund had a deficit. The Bank expects to continue providing to the Tourism Development Fund the necessary support through credit facilities to satisfy its obligations.

(d) Capital Fund

The Capital Fund had a net loss of \$20,348 for the year ended on June 30, 2013. Since the year ended June 30, 2010, the Capital Fund activities have been significantly reduced since most of its assets were transferred to the Tourism Development Fund.

(e) Public Finance Corporation

The Public Finance Corporation had a net loss of \$2,975 for the year ended on June 30, 2013. The main operation of this component unit is the issuance of special appropriation bonds. Interest income for fiscal year 2013 was \$1,208 offset by legal and professional fees, and other expenses of \$4,183.

(f) Development Fund

The Development Fund's net loss of \$19.7 million is mainly due to the provision for loan losses of \$6.2 million related to loans to the private sector and to the provision for losses on guarantees of \$13.6 million

At June 30, 2013, the Development Fund had a deficit. The Bank expects to continue providing to the Development Fund the necessary financial support through credit facilities to satisfy its obligations.

Economic factors

The Bank, along with the Commonwealth, has taken a number of steps during the last 14 months to enhance its liquidity, including:

- A recent \$3.5 billion bond issuance of Commonwealth general obligation bonds, which provided for the repayment of approximately \$1.9 billion of loans made by the Bank to the Commonwealth and the Public Buildings Authority.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

- In February 2014, the Governor of the Commonwealth announced that his administration would reduce the fiscal year 2014 deficit to \$650 million by proposing legislation to reduce fiscal year 2014 appropriations by \$170 million, and his commitment to recommend to the Legislature the approval of a balanced budget for fiscal year 2015.

Contacting the Bank's Financial Management

This report is designed to provide all interested parties with a general overview of the Bank's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, Puerto Rico, 00940-2001.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Net Position

June 30, 2013

Assets	Governmental activities	Business-type activities	Total
Cash and due from banks	\$ 12,641,328	65,016,755	77,658,083
Federal funds sold and securities purchased under agreements to resell	—	450,000,000	450,000,000
Deposits placed with banks	3,501,566	554,506,744	558,008,310
Due from federal government	10,997,325	—	10,997,325
Investments and investment contracts	62,027,302	2,953,530,901	3,015,558,203
Loans receivable – net	—	9,635,090,316	9,635,090,316
Accrued interest receivable	363,261	275,001,830	275,365,091
Real estate available for sale	—	65,595,067	65,595,067
Capital assets:			—
Land and other nondepreciable assets	—	90,017,697	90,017,697
Other capital assets	5,074	9,904,528	9,909,602
Other receivables	—	102,734,566	102,734,566
Deferred bonds and notes issue cost, and other assets	34,964	35,293,945	35,328,909
Total assets	89,570,820	14,236,692,349	14,326,263,169
Liabilities			
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:			
Demand	—	3,087,710,220	3,087,710,220
Certificates of deposit			
Due within one year	—	2,197,718,279	2,197,718,279
Due in more than one year	—	291,241,261	291,241,261
Securities sold under agreements to repurchase	—	634,301,000	634,301,000
Accrued interest payable	70,754	48,951,557	49,022,311
Accounts payable and accrued liabilities			
Due within one year	36,918,583	49,380,679	86,299,262
Due in more than one year	—	18,609,720	18,609,720
Internal balances	176,372,302	(176,372,302)	—
Allowance for losses on guarantees and letters of credit			
Due within one year	—	28,633,287	28,633,287
Due in more than one year	—	233,504,674	233,504,674
Allowance for losses on mortgage loan insurance	—	5,184,527	5,184,527
Participation agreement payable			
Due within one year	—	866,664	866,664
Due in more than one year	—	23,472,225	23,472,225
Bonds, notes, and mortgage-backed certificates payable			
Due within one year	—	424,742,825	424,742,825
Due in more than one year	3,430,564	4,862,220,354	4,865,650,918
Total liabilities	216,792,203	11,730,164,970	11,946,957,173
Net Position (Deficit)			
Net investment in capital assets	5,074	89,608,550	89,613,624
Restricted for:			
Mortgage loan insurance	—	64,954,464	64,954,464
Affordable housing programs	20,008,647	35,941,337	55,949,984
Debt service	—	66,113,543	66,113,543
Other housing programs	—	693,176	693,176
Unrestricted net position (deficit)	(147,235,104)	2,249,216,309	2,101,981,205
Total net position (deficit)	\$ (127,221,383)	2,506,527,379	2,379,305,996

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Activities
Year ended June 30, 2013

	<u>Program revenues</u>				<u>Net revenues/(expenses) and changes in net position (deficit)</u>		
	<u>Expenses</u>	<u>Charges for services – fees, commissions, and others</u>	<u>Charges (expenses) for services – financing and investment</u>	<u>Operating grants and contributions</u>	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Functions/programs:							
Governmental activities:							
General government and other	\$ 6,883,590	—	—	—	(6,883,590)	—	(6,883,590)
Housing assistance programs	230,366,311	—	3,922,627	170,501,118	(55,942,566)	—	(55,942,566)
Total governmental activities	<u>237,249,901</u>	<u>—</u>	<u>3,922,627</u>	<u>170,501,118</u>	<u>(62,826,156)</u>	<u>—</u>	<u>(62,826,156)</u>
Business-type activities:							
GDB Operating Fund	361,895,753	15,058,735	510,518,474	—	—	163,681,456	163,681,456
Housing Finance Authority	48,031,994	12,449,661	30,914,229	—	—	(4,668,104)	(4,668,104)
Tourism Development Fund	196,554,684	4,734,268	(6,407,867)	—	—	(198,228,283)	(198,228,283)
Public Finance Corporation	4,183	—	1,208	—	—	(2,975)	(2,975)
Capital Fund	34,045	13,570	127	—	—	(20,348)	(20,348)
Development Fund	20,179,348	101,164	331,020	—	—	(19,747,164)	(19,747,164)
Other nonmajor	127,254	—	2,488	—	—	(124,766)	(124,766)
Total business-type activities	<u>626,827,261</u>	<u>32,357,398</u>	<u>535,359,679</u>	<u>—</u>	<u>—</u>	<u>(59,110,184)</u>	<u>(59,110,184)</u>
Total	<u>\$ 864,077,162</u>	<u>32,357,398</u>	<u>539,282,306</u>	<u>170,501,118</u>	<u>(62,826,156)</u>	<u>(59,110,184)</u>	<u>(121,936,340)</u>
Transfers in (out) – net					1,226,294	(1,226,294)	—
Change in net position (deficit)					(61,599,862)	(60,336,478)	(121,936,340)
Net position (deficit) – beginning of year, as restated (see note 2 for further details)					(65,621,521)	2,566,863,857	2,501,242,336
Net position (deficit) – end of year					<u>\$ (127,221,383)</u>	<u>2,506,527,379</u>	<u>2,379,305,996</u>

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheet – Governmental Funds

June 30, 2013

	<u>HUD Programs</u>	<u>Home Program</u>	<u>AHMSP Act No. 124</u>	<u>My New Home Program</u>	<u>Nonmajor governmental funds</u>	<u>Eliminations</u>	<u>Total governmental funds</u>
Assets:							
Cash and due from banks	\$ 497,943	665,872	11,477,513	—	—	—	12,641,328
Deposits placed with banks	—	—	3,501,566	—	—	—	3,501,566
Due from federal government	1,080,927	9,916,398	—	—	—	—	10,997,325
Investments and investment contracts	—	—	62,027,302	—	—	—	62,027,302
Due from other funds	57,678	—	22,900,275	1,927,021	765,748	—	25,650,722
Interest and other receivables	7,248	—	356,012	—	—	—	363,260
Total assets	<u>\$ 1,643,796</u>	<u>10,582,270</u>	<u>100,262,668</u>	<u>1,927,021</u>	<u>765,748</u>	<u>—</u>	<u>115,181,503</u>
Liabilities:							
Due to other funds	\$ 1,023,514	1,365,174	52,626,613	92,937,220	54,070,503	—	202,023,024
Accounts payable and accrued liabilities	620,282	9,007,256	4,410,764	400,776	2,052,168	—	16,491,246
Deferred revenue	—	6,992,837	—	—	—	—	6,992,837
Total liabilities	<u>1,643,796</u>	<u>17,365,267</u>	<u>57,037,377</u>	<u>93,337,996</u>	<u>56,122,671</u>	<u>—</u>	<u>225,507,107</u>
Fund balances (deficit):							
Restricted for affordable housing programs	—	—	43,225,291	1,526,245	467,201	—	45,218,737
Unassigned	—	(6,782,997)	—	(92,937,220)	(55,824,124)	—	(155,544,341)
Total fund balances (deficit)	<u>—</u>	<u>(6,782,997)</u>	<u>43,225,291</u>	<u>(91,410,975)</u>	<u>(55,356,923)</u>	<u>—</u>	<u>(110,325,604)</u>
Total liabilities and fund balances	<u>\$ 1,643,796</u>	<u>10,582,270</u>	<u>100,262,668</u>	<u>1,927,021</u>	<u>765,748</u>	<u>—</u>	<u>115,181,503</u>
Amounts reported for governmental activities in the statement of net position are different because:							
Total fund deficit							\$ (110,325,604)
Deferred debt issue costs that are recorded as expenditures in governmental funds, but are capitalized in the government-wide financial statements							34,964
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds							5,074
Bonds and notes payable are not due and payable in the current period and therefore are not reported in the funds							(3,430,564)
Accounts payable and accrued liabilities not due and payable in the current period							(20,427,336)
Accrued interest payable not due and payable in the current period							(70,754)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds							6,992,837
Net position (deficit) of governmental activities							<u>\$ (127,221,383)</u>

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficit) – Governmental Funds
Year ended June 30, 2013

	<u>HUD Programs</u>	<u>Home Program</u>	<u>AHMSP Act No. 124</u>	<u>My New Home Program</u>	<u>Nonmajor governmental funds</u>	<u>Total governmental funds</u>
Revenues:						
Commonwealth appropriations for repayment of bonds and housing assistance programs	\$ —	—	1,188,927	—	—	1,188,927
Intergovernmental – federal government	140,784,231	21,198,199	—	—	—	161,982,430
Interest income on deposits placed with banks	—	—	120,644	33,819	738	155,201
Interest on investments	—	—	4,213,645	—	—	4,213,645
Net decrease in fair value of investments	—	—	(291,018)	—	—	(291,018)
Other	37,345	553,881	865,396	806,498	691,389	2,954,509
Total revenues	<u>140,821,576</u>	<u>21,752,080</u>	<u>6,097,594</u>	<u>840,317</u>	<u>692,127</u>	<u>170,203,694</u>
Expenditures:						
Current:						
General government and other	5,062,320	1,007,520	634,324	163,625	—	6,867,789
Housing assistance programs	135,759,256	24,899,459	18,363,826	44,592,230	21,828	223,636,599
Debt service:						
Interest	—	—	1,643,206	4,228,230	862,227	6,733,663
Total expenditures	<u>140,821,576</u>	<u>25,906,979</u>	<u>20,641,356</u>	<u>48,984,085</u>	<u>884,055</u>	<u>237,238,051</u>
Deficiency of revenues over expenditures	—	(4,154,899)	(14,543,762)	(48,143,768)	(191,928)	(67,034,357)
Other financing sources (uses):						
Transfers-in	—	—	1,242,217	5,000,000	885,252	7,127,469
Transfers-out	—	—	(5,901,175)	—	—	(5,901,175)
Total other financing sources (uses), net	<u>—</u>	<u>—</u>	<u>(4,658,958)</u>	<u>5,000,000</u>	<u>885,252</u>	<u>1,226,294</u>
Net change in fund balances (deficit)	<u>—</u>	<u>(4,154,899)</u>	<u>(19,202,720)</u>	<u>(43,143,768)</u>	<u>693,324</u>	<u>(65,808,063)</u>
Fund balances (deficit) – beginning of year, as restated (see note 2)	—	(2,628,098)	62,428,011	(48,267,207)	(56,050,247)	(44,517,541)
Fund balances (deficit) – end of year	\$ <u>—</u>	<u>(6,782,997)</u>	<u>43,225,291</u>	<u>(91,410,975)</u>	<u>(55,356,923)</u>	<u>(110,325,604)</u>
Amounts reported for governmental activities in the statement of net position are different because:						
Net change in fund balances (deficit) – total governmental funds						\$ (65,808,063)
Governmental funds report capital outlay as expenditures; however, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This amount is the depreciation for the year.						(17,067)
Capital assets recorded as expenditures, however, in the statement of activities, the cost of these assets is allocated over their estimated useful life and reported as depreciation expense.						3,107
Some expenses in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.						3,951
Revenue in the statement of activities that do not provide current financial resources are not reported as revenues in the governmental funds.						4,220,051
Governmental funds report the effect of issuance costs when debt is first issued, whereas these costs are deferred and amortized in the statement of activities. This amount is the amortization for the current year.						(1,841)
Change in net position (deficit) of governmental activities.						\$ <u>(61,599,862)</u>

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheet – Proprietary Funds

June 30, 2013

Assets	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Nonmajor enterprise funds	Eliminations	Total enterprise funds
Current assets:									
Cash and due from banks	\$ 64,462,608	1,220,115	21,710,611	1,190,045	—	6,419,012	2,430,818	(32,552,257)	64,880,952
Federal funds sold and securities purchased to resell	450,000,000	—	—	—	—	—	—	—	450,000,000
Deposits placed with banks	462,787,676	128,532,220	1,500,000	—	—	—	—	(108,536,010)	484,283,886
Investments and investment contracts	156,482,147	—	33,771,125	—	200,711	—	—	—	190,453,983
Loans receivable	1,074,525,765	6,852,517	1,371,665	—	—	4,321,625	—	(246,758,048)	840,313,524
Accrued interest receivable	278,797,451	2,084,726	364,026	99	8	27,400	204	(7,656,734)	273,617,180
Other current receivables	17,540,188	1,091,707	1,800,000	—	—	—	8	—	20,431,903
Other current assets	664,561	325,682	291,280	—	—	—	—	—	1,281,523
Due from governmental funds	196,905,997	5,117,027	—	—	—	—	—	—	202,023,024
Restricted:									
Cash and due from banks	—	1,375,687	—	—	—	—	—	(1,239,884)	135,803
Deposits placed with banks	—	112,696,486	—	—	—	—	—	(42,473,628)	70,222,858
Investments and investment contracts	51,092,500	32,860,013	—	—	—	—	—	—	83,952,513
Accrued interest receivable	—	1,465,461	—	—	—	—	—	(80,811)	1,384,650
Other current receivables	—	14,542	—	—	—	—	—	—	14,542
Total current assets	2,753,258,893	293,636,183	60,808,707	1,190,144	200,719	10,768,037	2,431,030	(439,297,372)	2,682,996,341
Noncurrent assets:									
Restricted:									
Investments and investment contracts	610,572,814	232,332,320	—	—	—	—	—	—	842,905,134
Loans receivable	—	83,021,910	—	—	—	—	—	—	83,021,910
Real estate available for sale	—	1,790,828	—	—	—	—	—	—	1,790,828
Other assets	—	2,907,736	—	—	—	—	—	—	2,907,736
Investments and investment contracts	1,695,272,955	18,067,395	119,263,712	—	—	3,615,209	—	—	1,836,219,271
Loans receivable, net	8,394,519,177	205,967,383	196,268,295	—	—	—	—	(84,999,973)	8,711,754,882
Real estate available for sale	54,678,269	9,125,970	—	—	—	—	—	—	63,804,239
Capital assets:									
Land and other nondepreciable assets	90,017,697	—	—	—	—	—	—	—	90,017,697
Other capital assets	7,900,225	2,004,303	—	—	—	—	—	—	9,904,528
Other receivables	82,288,121	—	—	—	—	—	—	—	82,288,121
Deferred bonds, notes issue costs, and other assets	31,104,686	—	—	—	—	—	—	—	31,104,686
Total noncurrent assets	10,966,353,944	555,217,845	315,532,007	—	—	3,615,209	—	(84,999,973)	11,755,719,032
Total assets	\$ 13,719,612,837	848,854,028	376,340,714	1,190,144	200,719	14,383,246	2,431,030	(524,297,345)	14,438,715,373

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Balance Sheet – Proprietary Funds

June 30, 2013

Liabilities and Net Position	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Nonmajor enterprise funds	Eliminations	Total enterprise funds
Current liabilities:									
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:									
Demand	\$ 3,124,702,807	—	—	—	—	—	—	(36,992,587)	3,087,710,220
Certificates of deposit	2,348,727,917	—	—	—	—	—	—	(151,009,638)	2,197,718,279
Securities sold under agreements to repurchase	634,301,000	—	—	—	—	—	—	—	634,301,000
Accrued interest payable	48,749,804	145,783	7,342,778	—	—	—	—	(7,737,545)	48,500,820
Accounts payable and accrued liabilities	29,948,343	11,116,093	1,139,115	53,899	27,357	127,187	34,031	3,200,446	45,646,471
Allowance for losses on guarantees and letters of credit	—	—	23,940,462	—	—	4,692,825	—	—	28,633,287
Due to governmental funds	25,650,722	—	—	—	—	—	—	—	25,650,722
Participation agreement payable	—	—	866,664	—	—	—	—	—	866,664
Notes payable	388,911,392	—	246,758,048	—	—	—	—	(246,758,048)	388,911,392
Total current liabilities payable from unrestricted assets	6,600,991,985	11,261,876	280,047,067	53,899	27,357	4,820,012	34,031	(439,297,372)	6,457,938,855
Current liabilities payable from restricted assets:									
Accrued interest payable	—	450,737	—	—	—	—	—	—	450,737
Accounts payable and accrued liabilities	—	3,734,208	—	—	—	—	—	—	3,734,208
Allowance for losses on mortgage loan insurance	—	5,184,527	—	—	—	—	—	—	5,184,527
Bonds, notes and mortgage-backed certificates payable	—	35,831,433	—	—	—	—	—	—	35,831,433
Total current liabilities	6,600,991,985	56,462,781	280,047,067	53,899	27,357	4,820,012	34,031	(439,297,372)	6,503,139,760
Noncurrent liabilities:									
Certificates of deposit, principally from the Commonwealth of Puerto Rico and its public entities	291,241,261	—	—	—	—	—	—	—	291,241,261
Allowance for losses on guarantees and letters of credit	—	—	223,904,792	—	—	9,599,882	—	—	233,504,674
Accounts payable and accrued liabilities	15,427,826	2,850,882	—	—	—	331,012	—	—	18,609,720
Participation agreement payable	—	—	23,472,225	—	—	—	—	—	23,472,225
Bonds and notes payable	4,606,754,579	—	84,999,973	—	—	—	—	(84,999,973)	4,606,754,579
Noncurrent liabilities payable from restricted assets:									
Bonds, notes and mortgage-backed certificates payable	—	255,465,775	—	—	—	—	—	—	255,465,775
Total noncurrent liabilities	4,913,423,666	258,316,657	332,376,990	—	—	9,930,894	—	(84,999,973)	5,429,048,234
Total liabilities	11,514,415,651	314,779,438	612,424,057	53,899	27,357	14,750,906	34,031	(524,297,345)	11,932,187,994
Net position (deficit):									
Net investment in capital assets	87,604,247	2,004,303	—	—	—	—	—	—	89,608,550
Restricted for:									
Mortgage loan insurance	—	64,954,464	—	—	—	—	—	—	64,954,464
Affordable housing programs	—	35,941,337	—	—	—	—	—	—	35,941,337
Debt service	—	66,113,543	—	—	—	—	—	—	66,113,543
Other housing programs	—	693,176	—	—	—	—	—	—	693,176
Unrestricted net position (deficit)	2,117,592,939	364,367,767	(236,083,343)	1,136,245	173,362	(367,660)	2,396,999	—	2,249,216,309
Total net position (deficit)	2,205,197,186	534,074,590	(236,083,343)	1,136,245	173,362	(367,660)	2,396,999	—	2,506,527,379
Total liabilities and net position (deficit)	\$ 13,719,612,837	848,854,028	376,340,714	1,190,144	200,719	14,383,246	2,431,030	(524,297,345)	14,438,715,373

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
Statement of Revenues, Expenses, and Changes in Net Position (Deficit) – Proprietary Funds
Year ended June 30, 2013

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Nonmajor enterprise funds	Total enterprise funds
Operating revenues:								
Investment income:								
Interest income on federal funds sold	\$ 4,144,576	—	—	—	—	—	—	4,144,576
Interest income on deposits placed with banks	1,862,927	1,787,103	30,707	1,208	—	10,044	2,488	3,694,477
Interest and dividend income on investments and investment contracts	63,914,057	13,794,989	1,499,544	—	127	320,976	—	79,529,693
Net decrease in fair value of investments	(65,558,468)	(3,259,081)	(8,598,533)	—	—	—	—	(77,416,082)
Total investment income (loss)	4,363,092	12,323,011	(7,068,282)	1,208	127	331,020	2,488	9,952,664
Interest income on loans receivable:								
Public sector	504,444,156	—	—	—	—	—	—	504,444,156
Private sector	1,711,226	18,591,218	660,415	—	—	—	—	20,962,859
Total interest income on loans receivable	506,155,382	18,591,218	660,415	—	—	—	—	525,407,015
Total investment income (loss) and interest income on loans receivable	510,518,474	30,914,229	(6,407,867)	1,208	127	331,020	2,488	535,359,679
Noninterest income:								
Fiscal agency fees	1,737,815	206,643	—	—	—	—	—	1,944,458
Commitment guarantee and other services fees	11,346,019	192,073	2,665,950	—	—	101,164	—	14,305,206
Mortgage loan insurance premiums	—	4,932,860	—	—	—	—	—	4,932,860
Servicing and contract administration fees, net	1,559,587	5,962,045	262,702	—	—	—	—	7,784,334
Net gain on sale of real estate available for sale	35,980	—	—	—	—	—	—	35,980
Other income	379,334	1,156,040	1,805,616	—	13,570	—	—	3,354,560
Total noninterest income	15,058,735	12,449,661	4,734,268	—	13,570	101,164	—	32,357,398
Total operating revenues (loss)	525,577,209	43,363,890	(1,673,599)	1,208	13,697	432,184	2,488	567,717,077
Operating expenses:								
Provision (recapture) for loan losses	—	(754,646)	23,773,732	—	—	6,236,980	—	29,256,066
Interest expense:								
Deposits	47,955,571	—	—	—	—	—	—	47,955,571
Securities sold under agreements to repurchase	4,255,995	—	—	—	—	—	—	4,255,995
Commercial paper	18,000	—	—	—	—	—	—	18,000
Bonds, notes and mortgage-backed certificates	235,091,271	24,871,487	15,493,547	—	—	—	—	275,456,305
Total interest expense	287,320,837	24,871,487	15,493,547	—	—	—	—	327,685,871
Noninterest expenses:								
Salaries and fringe benefits	26,752,906	11,090,757	277,243	—	—	—	75,358	38,196,264
Depreciation and amortization	1,142,565	927,883	—	—	—	—	—	2,070,448
Occupancy and equipment costs	3,611,190	2,281,018	3	—	—	—	—	5,892,211
Legal and professional fees	22,275,636	2,487,891	1,052,748	4,096	32,000	310,244	54,713	26,217,328
Office and administrative	961,995	1,684,720	41,534	—	2,045	—	—	2,690,294
Subsidy and trustee fees	10,400	331,438	—	—	—	—	—	341,838
Provision for losses on guarantees and letters of credit	—	—	155,913,928	—	—	13,628,225	—	169,542,153
Provision for losses on mortgages loan insurance	—	885,481	—	—	—	—	—	885,481
Other	4,589,040	3,156,482	1,949	87	—	3,899	(2,817)	7,748,640
Total noninterest expenses	59,343,732	22,845,670	157,287,405	4,183	34,045	13,942,368	127,254	253,584,657
Total operating expenses	346,664,569	46,962,511	196,554,684	4,183	34,045	20,179,348	127,254	610,526,594
Operating income (loss)	178,912,640	(3,598,621)	(198,228,283)	(2,975)	(20,348)	(19,747,164)	(124,766)	(42,809,517)
Nonoperating expenses:								
Loss on early extinguishment of debt	—	(1,068,050)	—	—	—	—	—	(1,068,050)
Contributions to others	(15,231,184)	(1,433)	—	—	—	—	—	(15,232,617)
Total nonoperating expenses	(15,231,184)	(1,069,483)	—	—	—	—	—	(16,300,667)
Transfers-in	—	15,923	28,781,250	—	—	—	100,000	28,897,173
Transfers-out	(28,881,250)	(1,242,217)	—	—	—	—	—	(30,123,467)
Change in net position (deficit)	134,800,206	(5,894,398)	(169,447,033)	(2,975)	(20,348)	(19,747,164)	(24,766)	(60,336,478)
Net position (deficit) – beginning of year	2,070,396,980	539,968,988	(66,636,310)	1,139,220	193,710	19,379,504	2,421,765	2,566,863,857
Net position (deficit) – end of year	\$ 2,205,197,186	534,074,590	(236,083,343)	1,136,245	173,362	(367,660)	2,396,999	2,506,527,379

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Proprietary Funds

Year ended June 30, 2013

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Nonmajor enterprise funds	Eliminations	Total enterprise funds
Cash flows from operating activities:									
Cash received from interest on housing program loans	\$ —	12,882,041	—	—	—	—	—	—	12,882,041
Cash paid for housing program loans originated	—	(36,148,871)	—	—	—	—	—	—	(36,148,871)
Principal collected on mortgage and construction on housing program loans	—	35,056,887	—	—	—	—	—	—	35,056,887
Cash received from recovery on loans	—	696,125	—	—	—	—	—	—	696,125
Guarantee fees collected	—	—	3,287,541	—	—	494,466	—	—	3,782,007
Payment of guarantees	—	—	—	—	—	(365,518)	—	—	(365,518)
Cash received from other operating noninterest revenues	15,817,083	7,405,633	—	—	13,570	—	61	—	23,236,347
Cash payment for other operating noninterest expenses	(59,175,623)	(23,764,669)	(2,072,116)	(4,140)	(26,401)	(304,125)	(126,583)	(8,599,124)	(94,072,781)
Cash received from mortgage loans insurance premiums	—	5,615,067	—	—	—	—	—	—	5,615,067
Due (from) to governmental funds	(99,819,754)	25,509,487	—	—	—	—	—	—	(74,310,267)
Net cash provided by/(used in) operating activities	(143,178,294)	27,251,700	1,215,425	(4,140)	(12,831)	(175,177)	(126,522)	(8,599,124)	(123,628,963)
Cash flows from noncapital:									
Financing activities:									
Contributions to other entities	(14,882,941)	(1,433)	—	—	—	—	—	—	(14,884,374)
Transfers-in	—	15,923	—	—	—	—	100,000	—	115,923
Transfers-out	(100,000)	(1,242,217)	—	—	—	—	—	—	(1,342,217)
Net increase (decrease) in:									
Deposits	(875,985,797)	—	(2,000,000)	—	—	—	—	16,566,343	(861,419,454)
Certificates of deposit	409,042,692	—	—	—	—	—	—	(39,887,523)	369,155,169
Proceeds from issuance of securities sold under agreements to repurchase	30,009,620,496	—	—	—	—	—	—	—	30,009,620,496
Payment of securities sold under agreements to repurchase	(30,259,803,830)	—	—	—	—	—	—	—	(30,259,803,830)
Proceeds from issuance of bonds, notes, and mortgage-backed securities	500,000,000	152,822,696	9,491,329	—	—	—	—	(108,792,890)	553,521,135
Repayments of bonds, notes and mortgage backed securities	(1,069,505,000)	(244,095,649)	(72,216,667)	—	—	—	—	174,430,807	(1,211,386,509)
Payment of bond issue costs	—	(758,722)	—	—	—	—	—	—	(758,722)
Payments to early extinguish of bonds payable in excess of principal	—	(1,068,052)	—	—	—	—	—	—	(1,068,052)
Interest paid	(279,676,501)	(12,322,579)	(350,106)	—	—	—	—	11,935,896	(280,413,290)
Net cash provided by (used in) noncapital financing activities	(1,581,290,881)	(106,650,033)	(65,075,444)	—	—	—	100,000	54,252,633	(1,698,663,725)
Cash flows from capital and related financing activities – acquisition of capital assets									
	(13,447,951)	(455,777)	—	—	—	—	—	—	(13,903,728)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Proprietary Funds

Year ended June 30, 2013

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Nonmajor enterprise Funds	Eliminations	Total enterprise funds
Cash flows from investing activities:									
Net decrease (increase) in:									
Federal funds sold and securities purchases under agreements to resell	\$ 27,900,000	—	—	—	—	—	—	—	27,900,000
Deposits placed with banks	442,212,324	(71,076,941)	11,875,816	—	—	—	—	39,887,523	422,898,722
Purchases of investments	(4,721,388,475)	(20,718,753)	(38,875,668)	—	(7,850)	—	—	—	(4,780,990,746)
Cash received from recovery on real estate available for sale	—	108,500	—	—	—	—	—	—	108,500
Proceeds from sales and redemptions of investments	6,767,714,145	171,089,075	92,751,657	—	20,827	—	—	—	7,031,575,704
Interest and dividends received on investments	77,940,125	15,956,538	1,588,945	1,296	(146)	331,202	2,490	(725,077)	95,095,373
Interest received on other than housing program loans	341,537,995	—	428,388	—	—	—	—	(11,210,818)	330,755,565
Origination of other than housing program loans	(2,289,824,806)	(30,135,000)	(35,119,653)	—	—	(3,883,605)	—	108,792,890	(2,250,170,174)
Fees collected on other than housing program loans	—	870,389	—	—	—	—	—	—	870,389
Principal collected on other than housing program loans	1,069,358,887	—	42,152,834	—	—	—	—	(174,430,807)	937,080,914
Proceeds from sale of real estate available for sale	4,235,880	1,117,155	—	—	—	—	—	—	5,353,035
Advances received on sale of real estate available for sale	13,408,800	—	—	—	—	—	—	—	13,408,800
Disbursements for acquisition and improvements to real estate available for sale	(2,001)	(3,632,950)	—	—	—	—	—	—	(3,634,951)
Net cash provided by (used in) investing activities	<u>1,733,092,874</u>	<u>63,578,013</u>	<u>74,802,319</u>	<u>1,296</u>	<u>12,831</u>	<u>(3,552,403)</u>	<u>2,490</u>	<u>(37,686,289)</u>	<u>1,830,251,131</u>
Net change in cash and due from banks	(4,824,252)	(16,276,097)	10,942,300	(2,844)	—	(3,727,580)	(24,032)	7,967,220	(5,945,285)
Cash and due from banks – beginning of year	69,286,860	18,871,899	10,768,311	1,192,889	—	10,146,592	2,454,850	(41,759,361)	70,962,040
Cash and due from banks – end of year	<u>\$ 64,462,608</u>	<u>2,595,802</u>	<u>21,710,611</u>	<u>1,190,045</u>	<u>—</u>	<u>6,419,012</u>	<u>2,430,818</u>	<u>(33,792,141)</u>	<u>65,016,755</u>
Reconciliation to enterprise funds:									
Balance sheet:									
Cash and due from banks – unrestricted	\$ 64,462,608	1,220,115	21,710,611	1,190,045	—	6,419,012	2,430,818	(32,552,257)	64,880,952
Cash and due from banks – restricted	—	1,375,687	—	—	—	—	—	(1,239,884)	135,803
Total cash and due from banks at year end	<u>\$ 64,462,608</u>	<u>2,595,802</u>	<u>21,710,611</u>	<u>1,190,045</u>	<u>—</u>	<u>6,419,012</u>	<u>2,430,818</u>	<u>(33,792,141)</u>	<u>65,016,755</u>

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Proprietary Funds

Year ended June 30, 2013

	<u>GDB Operating Fund</u>	<u>Housing Finance Authority</u>	<u>Tourism Development Fund</u>	<u>Public Finance Corporation</u>	<u>Capital Fund</u>	<u>Development Fund</u>	<u>Nonmajor enterprise funds</u>	<u>Eliminations</u>	<u>Total enterprise funds</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:									
Operating income (loss)	\$ 178,912,640	(3,598,621)	(198,228,283)	(2,975)	(20,348)	(19,747,164)	(124,766)	—	(42,809,517)
Adjustments to reconcile operating income/(loss) to net cash provided by (used in) operating activities:									
Investment income	(69,921,560)	(15,582,092)	(1,530,251)	(1,208)	(127)	(331,020)	(2,488)	—	(87,368,746)
Interest income on other than housing program loans	(506,155,382)	—	(660,415)	—	—	—	—	—	(506,815,797)
Other income	—	—	(1,805,616)	—	—	—	—	—	(1,805,616)
Capitalized interest and deferred amortization on loans	—	(5,530,217)	—	—	—	—	—	—	(5,530,217)
Tax credit fees	—	(174,619)	—	—	—	—	—	—	(174,619)
Interest expense	287,320,837	24,871,487	15,493,547	—	—	—	—	—	327,685,871
Provision for loan losses	—	(754,647)	23,773,732	—	—	6,236,980	—	—	29,256,065
Provision for losses on guarantees and letters of credit	—	—	155,913,928	—	—	13,628,225	—	—	169,542,153
Payment of guarantees	—	—	—	—	—	(365,518)	—	—	(365,518)
Net decrease in fair value of investments	65,558,468	3,259,081	8,598,533	—	—	—	—	—	77,416,082
Provision for losses on real estate available for sale	2,978,487	1,791,436	—	—	—	—	—	—	4,769,923
Provision for losses on mortgage loan insurance	—	885,481	—	—	—	—	—	—	885,481
Net decrease in market value of real estate available for sale	—	137,874	—	—	—	—	—	—	137,874
Credit for losses on other assets	(50,970)	—	—	—	—	—	—	—	(50,970)
Loss (gain) on sale of real estate held for sale	(35,980)	891,913	—	—	—	—	—	—	855,933
Depreciation and amortization	1,142,565	927,883	—	—	—	—	—	—	2,070,448
Changes in operating assets and liabilities:									
Housing program loans receivable	—	(36,148,871)	—	—	—	—	—	—	(36,148,871)
Collection of mortgage and construction loans	—	35,644,512	—	—	—	—	—	—	35,644,512
Interest receivable on housing program loans	—	(163,672)	—	—	—	—	—	—	(163,672)
Decrease (increase) in other assets	3,960,494	(232,227)	—	—	—	—	52	—	3,728,319
Increase (decrease) in other liabilities	(7,068,141)	(4,482,487)	357,549	43	7,644	10,018	680	(8,599,124)	(19,773,818)
Increase (decrease) in guarantee fees	—	—	(697,299)	—	—	393,302	—	—	(303,997)
Decrease (increase) in due from/(to) governmental funds	(99,819,752)	25,509,486	—	—	—	—	—	—	(74,310,266)
Net cash provided by (used in) operating activities	\$ <u>(143,178,294)</u>	<u>27,251,700</u>	<u>1,215,425</u>	<u>(4,140)</u>	<u>(12,831)</u>	<u>(175,177)</u>	<u>(126,522)</u>	<u>(8,599,124)</u>	<u>(123,628,963)</u>

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Proprietary Funds

Year ended June 30, 2013

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Nonmajor enterprise funds	Eliminations	Total enterprise funds
Noncash investing and noncapital financing activities:									
Accretion of discount and capitalized interest on investments securities and deposits placed with banks	\$ (1,756,241)	1,801,488	49,875	—	281	—	—	—	95,403
Capitalized interest on loans and other	8,127,570	4,419,603	—	—	—	—	—	(5,616,724)	6,930,449
Tax credit fees collected from loans	—	174,619	—	—	—	—	—	—	174,619
Increase in other receivables from sale or valuation of real estate available for sale	30,233,964	—	—	—	—	—	—	—	30,233,964
Increase of accrual of payments on land under development	817,745	—	—	—	—	—	—	—	817,745
Increase of accrual of contributions payable to others	348,243	—	—	—	—	—	—	—	348,243
Accretion of discount (premium) on bonds and notes payable	169,220	11,150,565	5,616,724	—	—	—	—	(5,616,724)	11,319,785
Noncash transfer:									
Transfers-out	28,781,250	21,116	—	—	—	—	—	—	28,802,366
Transfers-in	—	(21,116)	(28,781,250)	—	—	—	—	—	(28,802,366)
Principal and interest activity of participation agreement	—	—	1,253,035	—	—	—	—	—	1,253,035
Decrease in fair value of investments	(65,558,468)	(3,259,081)	(8,598,533)	—	—	—	—	—	(77,416,082)
Amortization of bond issue cost (included in interest expense)	5,803,292	1,065,990	—	—	—	—	—	—	6,869,282
Amortization of deferred loss	—	346,799	—	—	—	—	—	—	346,799
Interfund transfer of mortgage loans receivable to other real estate available for sale	—	15,312	—	—	—	—	—	—	15,312

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(1) Reporting Entity

Government Development Bank for Puerto Rico (the Bank or GDB) is a component unit of the Commonwealth of Puerto Rico (the Commonwealth) created by Act No. 17 of September 23, 1948, as amended. The Bank's principal functions are to act as fiscal agent, paying agent and financial advisor for the Commonwealth and its agencies, instrumentalities, and public corporations (collectively referred to as public entities) and municipalities; to make interim and long-term loans to public entities and municipalities and private enterprises, which will further the economic development of Puerto Rico; and to act as depository or trustee of funds for the Commonwealth, its public entities and municipalities. The charter of the Bank provides for its perpetual existence, and no amendment to the charter, or to any other law of Puerto Rico, shall impair any outstanding obligations or commitments of the Bank. The Bank is exempt from taxation in Puerto Rico. The Bank's charter, as amended, allows the Bank to invest in securities issued by any corporate entity engaged in the economic development of Puerto Rico, as well as to guarantee loans and other obligations incurred by public and private entities.

Pursuant to Act No. 82 of June 16, 2002, which amended the Bank's enabling legislation, the Bank may transfer annually to the general fund of the Commonwealth up to 10% of its net income or \$10 million, whichever is greater. Management of the Bank has defined net income as the increase in unrestricted net position of business-type activities for a fiscal year. The Bank's board of directors approved such definition. The Bank did not make this transfer for the year ended June 30, 2013.

The Bank has the following blended component units: Puerto Rico Housing Finance Authority (the Housing Finance Authority), Puerto Rico Tourism Development Fund (the Tourism Development Fund), Puerto Rico Development Fund (the Development Fund), Puerto Rico Public Finance Corporation (the Public Finance Corporation or PFC), Government Development Bank for Puerto Rico Capital Fund (the Capital Fund), José M. Berrocal Finance and Economics Institute (JMB Institute), and Puerto Rico Higher Education Assistance Corporation (the Education Assistance Corporation). The balances and transactions of the component units discussed above have been blended with those of the Bank in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) because, while legally separate, they were created and can be dissolved through resolution of the Bank's board of directors. The board of directors of each of the blended component units is substantially the same as that of the Bank. The Bank may impose its will or obtain a financial benefit or financial burden from each of the blended components units. Financial statements of the Housing Finance Authority, the Tourism Development Fund, and PFC may be obtained from the Bank.

The Housing Finance Authority was created in 1977 to provide public and private housing developers with interim and permanent financing through mortgage loans for the construction, improvement, operation, and maintenance of rental housing for low and moderate-income families. The Housing Finance Authority also issues bonds and notes, the proceeds of which are deposited in separate trusts and, generally, invested in mortgaged-backed securities collateralized by mortgage loans on properties located in Puerto Rico purchased by low and moderate-income families, or used to provide subsidies to such families for the acquisition of their primary residences. The Housing Finance Authority is authorized by the U.S. Department of Housing and Urban Development (HUD) to administer the U.S. Housing Act Section 8 Program in Puerto Rico, to administer the HOME Investment Partnerships (HOME) Program and to act as an approved mortgagee, both for multifamily rental units and for single-family homes. In addition, it is an

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

authorized issuer of Government National Mortgage Association (GNMA) mortgage-backed securities, and is Puerto Rico's State Credit Agency for the Low-Income Housing Tax Credit Program under Section 42 of the U.S. Internal Revenue Code. Some of the assets of the Housing Finance Authority are restricted for mortgage loan insurance operations as explained in note 14 of the basic financial statements.

The Housing Finance Authority is the State Housing Agency (SHA) in charge of implementing the Low-Income Housing Tax Credit Program (LIHTC) in Puerto Rico. The tax credits provide a financial incentive to construct, rehabilitate, and operate rental housing for low-income tenants. A 10-year tax credit is available for each unit set-aside for low-income use as long as eligible households occupy a specific portion of units in a building or project. The rents charged on the set-aside units are restricted and eligible households occupy them or such units becoming vacant must be held open for eligible households for at least 15 years, plus a minimum of 15 additional years that the Housing Finance Authority requires.

The Tourism Development Fund was created in 1993 to promote the hotel and tourism industry of the Commonwealth, primarily through the issuance of letters of credit and guarantees. The Tourism Development Fund is also authorized to make capital investments and provide direct financing to tourism-related projects. At June 30, 2013, the Tourism Development Fund had a deficit. The Bank expects to continue providing to the Tourism Development Fund the necessary financial support through credit facilities to satisfy its obligations.

The Development Fund was created in 1977 to expand the sources of financing available for the development of the private sector of the economy of Puerto Rico and to complement the Bank's lending program. The Development Fund may also guarantee obligations of private sector enterprises and invest in their equity securities. At June 30, 2013, the Development Fund had a deficit. The Bank expects to continue providing to the Development Fund the necessary financial support through credit facilities to satisfy its obligations.

The Public Finance Corporation was created in 1984 to provide the agencies and instrumentalities of the Commonwealth with alternate means of satisfying financial needs. The resolution creating the Public Finance Corporation states that if it were to be dissolved or cease to exist without a successor public entity being appointed, any funds or assets not required for the payment of its bonds or any other obligation, will be transferred to the Secretary of the Department of the Treasury of the Commonwealth (the Department of the Treasury) for deposit in the Commonwealth's general fund.

The Capital Fund was created in 1992 to expand the investment options available to the Bank and to administer, separately from the Bank's general investment operations, an equity investments process through professional equity investment managers. On May 31, 2010, the Board of Directors of the Capital Fund authorized the transfer of its investments portfolio of approximately \$72 million to the Tourism Development Fund. The transfer was completed on June 30, 2010. The Capital Fund's activities have been reduced significantly after June 30, 2010.

Nonmajor funds include the JMB Institute and the Education Assistance Corporation. The JMB Institute was created in 2002 to complement the Bank's mission of promoting economic development by providing specialized training on the theory and practice of public finances and economics to talented young professionals in order to attract them to join the public service. The Education Assistance Corporation was

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

created in 1981 to administer the Stafford Loan Program in Puerto Rico and guarantee the payment of student loans granted by financial institutions in Puerto Rico under certain terms and restrictions. The operations of this fund were transferred to a guarantee agency designated by the U.S. Department of Education. The Education Assistance Corporation is currently inactive.

(2) Restatement of Net Position (Deficit) and Fund Balance (Deficit)

During 2013, the Housing Finance Authority identified the following errors related to the prior year basic financial statements:

- a) Accounts payable and accrued liabilities in the governmental activities were understated by \$20,427,338 related to disallowed costs of the HOME Program. Such claim existed in prior year, but was not recognized. See note 19 for additional information.
- b) Accounts payable and accrued liabilities of the New Secure Housing Program fund (presented as a nonmajor governmental fund) were overstated by \$524,672. The accrual was based on a board resolution committing the funds for future events.

The impact of these errors on the beginning net position (deficit) reported in the government-wide financial statements was as follows:

	Governmental activities
Net position (deficit), July 1, 2012 as previously reported	\$ (45,718,855)
Increase in accounts payable and accrued expenses (a)	(20,427,338)
Decrease of accounts payable and accrued expenses (b)	524,672
Net position (deficit), July 1, 2012 as restated	\$ (65,621,521)

The effect of these errors, had they been corrected in prior year basic financial statements, would have decreased the change in net position in the governmental activities by approximately \$0.5 million, from a decrease in net position of \$(10.1) million to \$(9.6) million. The prior period correction related to the disallowed costs by HUD does not have an impact on the change in net position reported in the 2012 basic financial statements since claim relates to a previous period (2011).

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The impact of these errors on the beginning fund balance/(deficit) reported in the fund financial statements was as follows:

	Governmental funds
	Nonmajor governmental funds
Fund balance (deficit) July 1, 2012, see note 3	\$ (56,574,919)
Decrease of accounts payable and accrued expenses (b)	524,672
Fund balance (deficit) July 1, 2012 as restated	\$ (56,050,247)

The effect of the errors, had it been corrected in the prior year basic financial statements, would have decreased the net change in fund balance (deficit) from a \$(3.4) million to \$(2.9) million. The increase in accounts payable and accrued expenses in the HOME Program does not have an impact in the governmental fund financial statements since such amount was not due and payable as of June 30, 2012.

(3) Summary of Significant Accounting Policies

The accounting and reporting policies of the Bank conform to generally accepted accounting principles in the United States of America (U.S. GAAP), as applicable to governmental entities. The Bank follows Governmental Accounting Standards Board (GASB) statements under the hierarchy established by Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, in the preparation of its financial statements.

The preparation of financial statements in conformity with U.S. GAAP 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/expenditures during the reported period. Actual results could differ from those estimates.

(a) Basis of Presentation

Government-Wide Financial Statements

The statement of net position and the statement of activities report information on all activities of the Bank. The effect of interfund balances has been removed from the government-wide statement of net position, except for the residual amounts due between governmental and business-type activities. Internal balances are not included in the total column of the government-wide statement of net position. Interfund charges for services among functions of the government-wide statement of activities have not been eliminated. The Bank's activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through intergovernmental revenues and other nonexchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services and interest earned on

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

investment securities and loans. Following is a description of the Bank's government-wide financial statements.

The statement of net position presents the Bank's assets and liabilities, with the difference reported as net position. Net position is reported in three categories:

- Net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances of bonds, notes, mortgage and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- Restricted component of net position consists of restricted assets reduced by liabilities related to those assets. Restricted net assets result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted component of net position consists of net amount of the assets and liabilities that do not meet the definition of the two preceding categories. Unrestricted component of net position often is assigned, in order to indicate that management does not consider them to be available for general operations. Unrestricted component of net assets often has constraints on use that are imposed by management, but such constraints may be removed or modified.

When both restricted and unrestricted components of net position are available for use, it is the Bank's policy to use restricted components of net position, and then, unrestricted components of net position as they are needed.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include: (1) interest income on loans and investments, changes in the fair value of investments, and fees and charges to customers for services rendered, and (2) grants and contributions that are restricted to meet the operational or capital requirements of a particular function. Other items not meeting the definition of program revenues are reported as general revenues.

Fund Financial Statements

Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. The financial activities of the Bank that are reported in the accompanying basic financial statements have been classified into governmental and proprietary funds.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental and proprietary funds are reported as separate columns in the fund financial statements, with nonmajor funds being combined into a single column. Fund balances at the beginning of the year are restated to reflect changes in major fund definition. In the case of proprietary funds, each individual blended component unit of the Bank with the exception of JMB

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Institute and the Education Assistance Corporation, which have been grouped as other nonmajor funds, has been reported as a separate major fund in the fund financial statements. In the case of the Housing Finance Authority, all of its activities not classified and reported as governmental funds have been reported as a proprietary fund.

Fund balances for each governmental fund are displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

- Nonspendable – amounts that cannot be spent because they are either not in a spendable form (such as inventories and prepaid amounts) or are legally or contractually required to be maintained intact.
- Restricted – amounts that can be spent only for specific purposes because of constraints imposed by external providers (such as grantors, bondholders, and higher levels of government), or imposed by constitutional provisions or enabling legislation.
- Committed – amounts that can be spent only for specific purposes determined by a formal action of the government’s highest level of decision-making authority. The Bank’s highest decision-making level of authority rests with Bank’s Board of Directors. The Bank did not have any committed resources as of June 30, 2013.
- Assigned – amounts with specific constraints generally designated by executive orders of the Bank’s President that do not meet the criteria to be classified as restricted or committed.
- Unassigned – amounts that are available for any purpose.

When both restricted and unrestricted resources (the total amount of committed, assigned and unassigned fund balance) are available for use, it is the Bank’s policy to use restricted resources first, and then, unrestricted resources as they are needed. Further when components of unrestricted fund balance can be used for the same purpose, committed fund balance is depleted first followed by assigned fund balance. Unassigned fund balance is applied last.

The following governmental activities of the Bank are classified as major governmental funds:

- HUD Programs – This special revenue fund accounts for the subsidy to low and moderate-income families for the rental of decent and safe dwellings under the U.S. Housing Act Section 8 programs.
- HOME Program – This special revenue fund is used to account for the specific revenue sources related to the HOME Program. The objectives of this special revenue fund include: (1) expanding the supply of decent and affordable housing, particularly housing for low-income families; (2) strengthening the abilities of state and local governments to design and implement strategies for achieving adequate supplies of decent, affordable housing; (3) providing financial and technical assistance to participating jurisdictions, including the development of model programs for affordable low-income housing; and (4) extending and strengthening partnership

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

among all levels of government and private sector, including for-profit and nonprofit organizations, in the production and operation of affordable housing.

- Affordable Housing Mortgage Subsidy Programs (AHMSP) Act No. 124 – This special revenue fund is used to account for the proceeds of specific revenue sources under different stages of the AHMSP that are legally restricted for expenditures to promote the origination of mortgage loans by financial institutions in the private sector to low and moderate income families. Under this program, the Authority commits to provide a subsidy for the down payment and/or the principal and interest payments on mortgage loans originated under a predetermined schedule of originations. Loans originated, as well as servicing, are kept by the originating financial institution. There was no open schedule of originations under this program as of June 30, 2013.
- My New Home Program – This special revenue fund accounts for revenues provided by Act No. 122 of August 6, 2010, as amended, which assigned to the Housing Finance Authority, for a period of seven years, a portion of no less than 80% of the unreserved monies and other liquid funds abandoned or unclaimed in financial institutions that will be transferred to the general fund of the Commonwealth. This program provides subsidies to eligible families in the purchase of a primary residence through reimbursement of origination and closing costs.

The following governmental activities of the Bank are accounted for in other nonmajor governmental funds:

- Closing Costs Assistance Program – This special revenue fund accounts for revenues received mainly from appropriations from the Commonwealth to provide closing costs subsidies to eligible individuals or families for the purchase of an eligible principal residence.
- New Secure Housing Program – This special revenue fund is used to account for federal and local resources directed to plan, coordinate, and develop the construction of new housing units as a replacement for those destroyed by Hurricane Georges in 1998 and to assist with the housing needs of those families living in hazard-prone areas.

Change in Governmental Funds Presentation

Annually, the Housing Finance Authority reassess the presentation of all its funds. During the year ended June 30, 2013, the presentation of AHMSP Stages 2, 3, 6, 7, 8, 11, AHMSP Act No. 124, AHMSP Mortgage-Backed Certificates and Protecting Your Home Program (collectively the Funds) and the Home Program was changed. Since the funding of the operations of the Funds is coming from AHMSP Act No. 124, the Housing Finance Authority combined the Funds related to a single major fund named AHMSP Act. No. 124 in the governmental funds of the basic financial statements. In prior year, the AHMSP Stage 7 fund was presented as a major governmental fund and the remaining funds were presented as individual nonmajor governmental funds in the basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The impact of the change in presentation on the beginning fund balance (deficit) reported in the fund financial statements as of July 1, 2012 was as follows:

	Governmental funds			
	Home Program	AHMSP Act No. 124	Affordable Housing Mortgage Subsidy Program Stage 7	Nonmajor governmental funds
Fund balance (deficit), July 1, 2012 as previously reported	\$ —	—	(20,473,557)	23,698,551
Change of governmental fund from nonmajor to major	(2,628,098)	—	—	2,628,098
Combination of all funds related to the Affordable Housing Mortgage Subsidy Programs	—	62,428,011	20,473,557	(82,901,568)
Change in fund balance as a result of restatement (see note 2)	—	—	—	524,672
Fund balance (deficit), July 1, 2012	\$ (2,628,098)	62,428,011	—	(56,050,247)

(b) Measurement Focus and Basis of Accounting

The government-wide financial statements and 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 a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

The governmental fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Bank considers revenues to be available if they are collected within 120 days after the end of the fiscal year. Principal revenue sources considered susceptible to accrual include federal and Commonwealth funds to be received by the HUD Programs, HOME Program and Closing Costs Assistance Program. Other revenues are considered to be measurable and available only when cash is received. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, principal and interest on general long term debt, claims and judgments, and compensated absences are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long term debt and acquisitions under capital leases are reported as other financing sources.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses are those that result from the Bank and its components units providing the services that correspond to their principal ongoing operations. Operating revenues are generated from lending, investing, banking and fiscal agency services, and other related activities. Operating expenses include interest expense, any provision for losses on loans, advances, letters of credit, or guarantees and all general and administrative expenses, among others. Revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

(c) *Securities Purchased under Agreements to Resell*

The Bank enters into purchases of securities under agreements to resell. The amounts advanced under these agreements generally represent short-term loans and are reflected as an asset. The securities underlying these agreements are usually held by the broker or his/her agent with whom the agreement is transacted. As of June 30, 2013, securities purchased under agreements to resell amounting to \$300,000,000 were outstanding.

(d) *Investments and Investment Contracts*

Investments and investment contracts are reported at fair value, except for money market instruments and participating investment contracts with a remaining maturity at the time of purchase of one year or less, and nonparticipating investment contracts (guaranteed investment contracts), which are carried at cost; and investment positions in 2a-7 like external investment pools, which are carried at the pools' share price. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations or based on upon quoted prices for similar instruments in active markets. Realized gains and losses from the sale of investments and unrealized changes in the fair value of outstanding investments are included in net increase (decrease) in fair value of investments.

(e) *Loans Receivable and Allowance for Loan Losses General Policy*

General Policy— Loans are presented at the outstanding unpaid principal balance reduced by the allowance for loan losses. The allowance for loan losses is established through a provision recorded in the statement of activities. The Bank determines the allowance for loan losses by portfolio sector, which consist of the public and private sector loans. The allowance for loan losses is based on management's evaluation of the risk characteristics of the loans including such factors as the nature of individual credits outstanding, past loss experience, known and inherent risks in the portfolios, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and general economic conditions. Loan charge-offs are recorded against the allowance when management believes that the collection of the principal is unlikely. Recoveries of amounts previously charged off are credited to the respective allowance. Because of uncertainties inherent in the estimation process, management's estimate of credit losses in the outstanding loans receivable portfolios and the related allowance may change in the near future.

i. Allowance for Loan Losses – Public Sector

One of the Bank's principal functions is to provide financing to the Commonwealth and its public entities and municipalities of the Commonwealth. This financing includes interim financing of

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

capital improvements payable from Commonwealth's general obligation bonds or revenue bonds issued by the corresponding public entity, and loans to finance the Commonwealth's budget deficit payable from the Puerto Rico Sales Tax Financing Corporation (the Sales Tax Corporation or COFINA), seasonal collection of income taxes and annual appropriations made by the Legislature. The aggregate amount of these loans has increased in recent years as a result of (i) the deterioration of the fiscal situation and financial condition of the Commonwealth and its public entities, and (ii) general market conditions, which in turn have negatively affected the ability of the Commonwealth and its public entities to permanently finance their capital expenditures and operating deficits by issuing bonds and notes.

The access of the Commonwealth and its public entities to funding through the bond market to finance their capital improvement programs, as well as any future operating deficits, may be affected by changes in their respective credit ratings. The credit ratings of the Commonwealth and some of its public entities have been downgraded, and the Bank may be asked to provide financing for these capital improvement programs and/or for working capital needs if access to the bond markets is limited. These interim financings are granted by the Bank as part of its role of providing financing, with or without guarantees, to the Commonwealth of Puerto Rico and its public entities; however, the Bank is not required by law to provide such financing. Under Act No. 164 of 2001, as amended, the Bank is prohibited from making loans to any public entity for which the source of repayment consists of appropriations from the General Fund without first obtaining the approval of the Legislature, with certain limited exceptions, including up to an aggregate amount of \$100 million in loans without the Legislature approval and including loans needed to cover the governmental entity's debt service. The Bank generally does not provide financing to any governmental entity of the Commonwealth unless the Bank reasonably believes that the borrowing governmental entity will have sufficient resources, including the ability to issue bonds or notes or otherwise borrow funds, or has a source of repayment as provided by law, to repay such loan. The Bank, however, has provided financing in the past and may continue to provide financing to government entities that do not have sufficient independent resources to cover operating expenses, to the extent permitted by law. Act No. 164-2001, as amended by Act No. 24 of 2014, places significant restrictions on the Bank's ability to extend credit to the Commonwealth and its public corporations when the source of repayment consists of future legislative appropriations or increases in rates, taxes or other charges that have not been previously approved.

In order to assess the inherent credit risk on the public sector loans, management's assessment methodology consists mainly in segregating the public sectors loans by repayment source and determining probable credit losses related to specifically identified loans as well as probable credit losses inherent in the remainder of the loan portfolio. Public entities loans; are segregated by the following sources of repayment: proceeds from bonds and notes issuances, operating revenues, legislative appropriations, and other sources. The municipalities loans are segregated by the following sources of repayment: collections of property tax, collections of municipal sales and use tax, operating revenues, and other sources.

As further explained in notes 4 and 7, management believes the inherent credit risk of its public entities and municipalities loan portfolios is low as evidenced by the minimal historical losses

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

incurred along with other mitigating factors, including the ability of the Commonwealth to enact laws and ultimately provide for a definitive repayment source and to the fact that the Director of the Puerto Rico Office of Management and Budget (“OMB”) has included in the budget of the Commonwealth appropriations to assist the Commonwealth and certain of its public entities and municipalities requiring financial support in repaying their loans with the Bank. The Legislature has historically approved these appropriations, and such practice is anticipated to continue in the future. In addition, management’s estimate of the allowance for loan losses is based on the fact that the Bank has been able to collect most of the loans to such public and municipalities sectors with proceeds from bonds or notes issued by the Commonwealth or its public entities, including bonds issued by COFINA, a component unit of the Commonwealth. The Commonwealth and its public entities have never defaulted on their respective bonds. The Bank has, in the past, collected the outstanding principal and interest at the contractual rate on loans repaid from the Commonwealth’s appropriations, or bond or note proceeds.

For loans to public entities and municipalities, the accrual of interest ceases only when management determines that all of the following characteristics are present, thus the mere existence of several but not all of these attributes does not warrant the discontinuance of interest income recognition: (a) a loan is six months past due; (b) it has no definitive source of repayment; (c) it is not covered by a formal commitment from the Commonwealth; and (d) it has no designated collateral or such collateral is insufficient. Once a loan is placed in nonaccrual status, all accrued interest receivable is reversed from interest income. Interest income on nonaccrual loans is thereafter recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when management has adequate evidence to believe that the loans will be performing as contracted. Furthermore, the lending cycle of the Bank is somewhat longer than the usual cycle of a financial institution to the extent that the ultimate collection of the legal balance of its public entities and municipalities portfolios, and the related interest receivable, is intrinsically related to their ability to access the capital markets. Thus, a delay in bonding out the outstanding loans and lines of credit does not automatically warrant non-performing classification and discontinuance of interest income.

ii. Allowance for Loan Losses – Private Sector

Another function of the Bank is to provide financing to private entities that operate within specific industries of interest to the Commonwealth due to the economic impact of its operations to the Puerto Rico economy. All of these transactions are approved by the Board of Directors of the Bank and as of June 30, 2013, are mainly related to the dairy, tourism industry and affordable housing programs in Puerto Rico. The Housing Finance Authority grants mortgage loans to low and moderate-income families for the acquisition of single-family housing units and to developers of low and moderate-income multifamily housing units in Puerto Rico. The accrual of interest on loans to the private sector ceases when loans become past due over six months.

Loans considered to be impaired are generally reduced to the present value of expected future cash flows, discounted at the loan’s effective interest rate or, as a practical expedient, at the loan’s observable market price or the fair value of the collateral if the loan is collateral dependent, by establishing a valuation allowance.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

As a general procedure, the Bank internally reviews appraisals as part of the underwriting and approval process and also for credits considered impaired that exceed certain thresholds. Appraisals may be adjusted by management due to their age, property conditions, geographical area or general market conditions as deemed necessary. The adjustments applied are based upon internal information, such as other appraisals and/or loss severity information available in several real estate market publications.

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

Management of the Bank periodically evaluates the credit risk inherent in the guarantees and letters of credit portfolio on the same basis as loans are evaluated. The Bank charges as expense the amount required to cover estimated losses by establishing a specific allowance component for guarantees and letters of credit relating to debt in default, determined on the basis of the estimated future net cash outlays in connection with the related guarantees and letters of credit, or the fair value of the debt's collateral, 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 debt, based on the Bank's loss experience on financial guarantees and letters of credit, and management's best judgment.

When a guarantee or letter of credit is honored, the Bank recognizes any disbursement as a nonperforming loan; therefore, no interest is accrued on the principal. After a specific analysis of the provision requirements, the related allowance included in the allowance for guarantees and letters of credit is reclassified to the allowance for loan losses. Any deficiency in the estimated allowance requirement is recorded as an additional provision to the allowance for loan losses.

The concentration of risk in the guarantees and letters of credit issued, predominantly those issued by the Tourism Development Fund (small number of large guarantees, geographical concentration in Puerto Rico, industry concentration in hotel and tourism), as well as other economic factors, compounds the uncertainty in management's 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 Bank may differ from the allowance for losses as reflected in the accompanying basic financial statements, and such differences may be material.

Pursuant to the legislation under which the Tourism Development Fund was created, the executive director of the Tourism Development Fund is required to certify each year to the Director of the OMB the amount, if any, that is necessary to reimburse the Tourism Development Fund for disbursements made, as defined, in the previous year in excess of revenues collected (net disbursement). On December 16, 2009, Act No. 173 was enacted, which amended the legislation that created the Tourism Development Fund, to modify the definition of net disbursement to include disbursements made by the Tourism Development Fund for (i) loans to third parties, (ii) the acquisition of loan participations, and (iii) the acceleration of maturities of loans, notes, bonds or other type of debt guaranteed by the Tourism Development Fund. However, Act No. 173 provides that such disbursements shall not be deemed made in the year in which the disbursement occurs but shall be deemed made in the year in which the executive director of the Tourism Development Fund determines that a loss was incurred with respect to a loan, note, bond or debt (such determination

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

being referred to as a realized loss). The Director of OMB may include the amount subject to reimbursement in the general fund budget of the Commonwealth for the following fiscal year for the Legislature's consideration and approval. The Legislature is not obligated to authorize such appropriations. As of June 30, 2013, there were no outstanding claims for reimbursements.

(g) Debt Issue Costs

Debt issue costs are deferred and amortized, as a component of interest expense, over the term of the related debt using the effective interest method. Issuance costs of bonds accounted for in the governmental funds are recorded as expenditures when paid.

(h) Real Estate Available for Sale

Real estate available for sale comprises properties acquired in lieu of payment and through foreclosure proceedings. It also includes loans that are treated as if the underlying collateral had been foreclosed because the Bank has taken possession of the collateral, even though legal foreclosure or repossession proceedings have not taken place. Those properties are carried at the lower of cost or fair value, which is established by the Bank by using a third party professional assessment or based upon an appraisal, minus estimated costs to sell. At the time of acquisition of properties in full or in partial satisfaction of loans, any excess of the loan balance over the fair value of the properties minus estimated costs to sell is charged against the allowance for loan losses. Subsequent declines in the value of real estate available for sale are charged to expense. Gain or loss on sale of real estate available for sale is included within revenues or expenses in the accompanying statement of activities and within noninterest income or noninterest expense in the accompanying statement of revenues, expenses, and changes in net position.

(i) Capital Assets

Capital assets, which include premises and equipment, are stated at cost less accumulated depreciation and amortization. Capital assets are defined by the Bank as assets that have a cost of \$500 or more at the date of acquisition and have an expected useful life of three or more years. Depreciation is charged to operations and included within expenses, and is computed on the straight-line basis over the estimated useful lives of the depreciable assets. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Costs of maintenance and repairs which do not improve or extend the lives of the respective assets are charged to expense as incurred.

Estimated useful lives are as follows:

Building	40 years
Leasehold improvements	Lesser of 10 years or lease term
Information systems	3-5 years
Office furniture and equipment	5 years
Vehicles	5 years

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(j) *Securities Sold under Agreements to Repurchase*

The Bank enters into sales of securities under agreements to repurchase. These agreements generally represent short-term financings and are reflected as a liability. The securities underlying these agreements are usually held by the broker or his/her agent with whom the agreement is transacted.

(k) *Compensated Absences*

The employees of the Bank are granted 30 days of vacation and 18 days of sick leave annually. Vacation and sick leave may be accumulated up to a maximum of 72 and 90 days, respectively. In the event of employee resignation, an employee is reimbursed for accumulated vacation and sick leave days up to the maximum allowed. The proprietary fund financial statements present the cost of accumulated vacation and sick leave within accounts payable and accrued liabilities.

(l) *Allowance for Losses on Mortgage Loan Insurance*

The estimated liability for losses on mortgage loan insurance is based on management's evaluation of potential losses on insurance claims after considering economic conditions, market value of related property, and other pertinent factors. Such amount is, in the opinion of management, adequate to cover estimated future probable mortgage loan insurance losses. Actual losses for mortgage loan insurance are charged, and recoveries, if any, are credited to the estimated liability for losses on mortgage loan insurance. Because of uncertainties inherent in the estimation process, management's estimate of losses in the outstanding loan guarantee portfolio and the related liability may change in the near future.

(m) *Deferred Revenues*

Deferred revenues at the governmental fund level arise when potential revenues do not meet the available criterion for recognition in the current period. Available is defined as due at June 30 and expected to be collected within 120 days thereafter to pay obligations due at June 30. Deferred revenues at the government-wide level arise only when the Bank receives resources before it has a legal claim to them.

(n) *Refundings*

Refundings involve the issuance of new debt whose proceeds are used to repay immediately (current refunding) or at a future time (advance refunding) previously issued debt. The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is recorded as an addition to or deduction from the new debt.

(o) *Conduit Debt*

The Housing Finance Authority has issued notes and bonds in connection with the financing of low and moderate-income housing projects. Certain of the obligations issued by the Housing Finance Authority are considered conduit debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements. The Bank, the Housing Finance Authority and the

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Commonwealth, except for the assets held in trust and earnings thereon, are not liable directly or indirectly for the payment of such obligations.

Certain other collateralized obligations of the Housing Finance Authority are included in the accompanying basic financial statements either because they represent general obligations of the Housing Finance Authority or it maintains effective control over the assets transferred as collateral.

From time to time, the Public Finance Corporation issues bonds, the proceeds of which are used to purchase from the GDB Operating Fund promissory notes of the Commonwealth, and of certain of its public entities, or to refund such previously issued bonds. The bonds are limited obligations of the Public Finance Corporation and, except to the extent payable from bond proceeds and investments thereon, are payable solely from the pledge and assignment of amounts due on the notes. Principal and interest on the notes are payable solely from legislative appropriations to be made pursuant to acts approved by the Legislature. The underlying notes represent debt of the issuing instrumentalities. The bonds are considered conduit debt, and therefore neither the bonds nor the notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements.

(p) *Loan Origination Costs and Commitment Fees*

Governmental accounting standard pronouncements, require that loan origination and commitment fees and direct origination costs be amortized over the contractual life of the related loan. The Bank generally recognizes commitment fees as income when collected and the related loan origination costs as expense when incurred. In the opinion of management, the difference between the two methods does not have a significant effect on the Bank's net position and changes in net position.

(q) *Guarantee Fees*

Guarantee fees are amortized over the life of the related guarantee using the straight-line method.

(r) *Transfers of Receivables*

Transfers of receivables are accounted and reported as a sale if the Bank's continuing involvement with those receivable is effectively terminated. This approach distinguishes transfers of receivables that are sales from transfers that are collateralized borrowings.

The Bank's continuing involvement is considered to be effectively terminated if all of the following criteria are met: (i) the transferee's ability to subsequently sell or pledge the receivables is not significantly limited by constraints imposed by the Bank, either in the transfer agreement or through other means, (ii) the Bank does not have the option or ability to unilaterally substitute for or reacquire specific accounts from among the receivables transferred, except in certain limited circumstances, (iii) the sale agreement is not cancelable by either party, including cancellation through payment of a lump sum or transfer of other assets or rights, and (iv) the receivables and the cash resulting from their collection have been isolated from the Bank.

The Housing Finance Authority services loans for investors and receives servicing fees generally based on stipulated percentages of the outstanding principal balance of such loans. Loan servicing

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

fees, late charges, and other miscellaneous fees are recognized as revenues as the related mortgage payments are collected, net of fees due to any third-party servicers. No servicing asset is recognized since fees are considered adequate compensation.

(s) ***Mortgage Loan Insurance Premiums***

Premiums on insured mortgage loans are recognized as earned during the period of the insurance coverage.

(v) ***Future Adoption of Accounting Pronouncements***

The GASB has issued the following Statements:

- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is effective for periods beginning after December 15, 2012. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities, or vice versa. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations.
- GASB Statement No. 66, *Technical Corrections-2012 – an Amendment of GASB Statements No. 10 and No. 62*, which is effective for periods beginning after December 15, 2012. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. As a result, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement No. 54 and Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. This Statement also amends Statement No. 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

- GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*, which is effective for periods beginning after June 15, 2013. The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements No. 25 and No. 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.
- GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*, which is effective for periods beginning after June 15, 2014. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements No. 27 and No. 50 remain applicable for pensions that are not covered by the scope of this Statement. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014.
- GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, which is effective for periods beginning after December 15, 2013. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

The distinction between a government merger and a government acquisition is based upon whether an exchange of significant consideration is present within the combination transaction. Government mergers include combinations of legally separate entities without the exchange of significant consideration. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This Statement also provides

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. This Statement defines the term operations for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations.

A disposal of a government's operations results in the removal of specific activities of a government. This Statement provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold.

- GASB Statement No. 70, *Accounting and Financial Reporting for Non Exchange Financial Guarantees*, which is effective for periods beginning after June 15, 2013. The objective of this Statement is to improve accounting and financial reporting by state and local government that extend and receive nonexchange financial guarantees. This Statement requires a governmental entity guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. Certain qualitative factors should be considered when evaluating the likelihood of a guaranty payment, such as: initiation of a bankruptcy process, breach of a debt contract in relation to the guaranteed obligation and indications of significant financial difficulty such as failure to pay agents or trustees. Management is evaluating the impact that these statements will have on the Bank's basic financial statements.

(4) Liquidity Risk and Recent Credit Rating Downgrades of the Commonwealth and its Public Entities including the Bank

(a) Background

The Bank has traditionally served as interim lender to the Commonwealth and its public entities in anticipation of the issuance of long-term bonds and notes by such entities in the municipal bond market. The Bank has also provided financing to the Commonwealth and its public entities to finance their respective budget deficits, collateral requirements under swap agreements and to meet mandatory payments of obligations. As a result of this lending function, the Bank serves as the principal source of short-term liquidity for the Commonwealth and its public entities.

Liquidity risk is the ability to raise cash when needed to meet obligations when they are due, at a reasonable cost and with minimum loss. Loans to the Commonwealth and its public entities constitute a significant portion of the Bank's assets. As a result, the Bank's liquidity and financial condition depends to a large extent on the repayment of loans made to the Commonwealth and its public entities, which face significant fiscal and financial challenges. Conditions that adversely affect the ability of the Commonwealth and its public entities to raise cash (including access to the bond market) and repay their interim and other loans to the Bank have an adverse effect on the Bank's liquidity and financial condition. Similarly, conditions that adversely affect the ability of the Bank to raise cash (including access to the bond market) or otherwise finance its loan portfolio also have an adverse effect on the Commonwealth and its public entities, as the Bank's ability to continue providing interim and deficit financing to the Commonwealth and its public entities is reduced.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(b) *Factors Affecting Liquidity*

The Commonwealth's recurring expenditures have exceeded its recurring revenues during the past fourteen years. During the fiscal year ended June 30, 2013, and subsequent to the end of the fiscal year, the Bank's liquidity position was adversely affected by, among other factors, a significant increase in credit spreads for obligations of the Commonwealth and its public entities, the Commonwealth's limited capital markets access, and a significant reduction of liquidity in the local Puerto Rico capital markets. In February 2014, the credit ratings of the Commonwealth and most of its public entities (including the Bank) were lowered to noninvestment grade categories. With respect to the Bank, Moody's Investors Service (Moody's) lowered its credit rating to "Ba2" and maintained its negative outlook, while Standard & Poors Rating Services (S&P) lowered its credit rating to "BB" and maintained it in "CreditWatch" with negative implications. These factors have resulted in delays in the repayment by the Commonwealth and its public entities of their loans payable to the Bank and, at the same time, caused the Commonwealth and its public entities to rely more heavily on short-term financing from the Bank. The credit rating downgrades could further adversely affect the Bank's liquidity position.

In addition, the liquidity of the Bank could also be affected by short-term obligations of the Commonwealth and its public entities maturing during fiscal years 2014 and 2015, some of which are also subject to earlier acceleration as a result of the downgrades. The majority of these short-term obligations of the Commonwealth and its public entities were refinanced with proceeds from the recent issuance of Commonwealth general obligation bonds (described below). However, several of such short-term obligations of the Commonwealth and its public entities remain outstanding. Although the Bank has previously assisted the Commonwealth and its public entities in satisfying obligations similar to those listed above, the Bank is not legally required to provide such assistance and there is no assurance that it will be able to continue to provide such assistance to any or all of the Commonwealth and its public entities. To the extent that the Bank financing is unavailable, the Commonwealth and its public entities may be required to find other sources of funding in order to meet their obligations. There is no assurance that the Commonwealth and its public entities will be able to access other sources of financing or obtain funding sufficient at any one time to meet their obligations as they come due. If such other financing or funding sources are not available, the financial condition of the Commonwealth and the public entities could deteriorate further and their ability to repay their loans to the Bank may be adversely affected.

(c) *Measures to Improve Liquidity*

The Bank, along with the Commonwealth, has taken a number of steps to enhance its liquidity, including:

- During March 2014, there was a \$3.5 billion bond issuance of Commonwealth general obligation bonds, which provided for the repayment of approximately \$1.9 billion of loans made by the Bank to the Commonwealth and the Public Buildings Authority (PBA), reducing the outstanding balance of the Bank's loans to the Commonwealth by \$1.7 billion and of Bank's loans to PBA by \$187 million.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

- In February 2014, the Governor of the Commonwealth announced that his administration would reduce the fiscal year 2014 deficit to \$650 million by proposing legislation to reduce fiscal year 2014 appropriations by \$170 million, and his commitment to recommend to the Legislature the approval of a balanced budget for fiscal year 2015. These measures, if achieved, would lessen the pressure on the Bank of continuing to provide loans to the Commonwealth to finance operational deficits.
- Under recently enacted legislation, the Bank has the legal authority to require that certain public funds currently deposited at private financial institutions, including demand deposit accounts, be deposited at the Bank, subject to specified exceptions.
- Recently enacted Act No. 24 of 2014 prohibits the Bank, subject to certain limited exceptions, from making loans to public entities payable from future increases in rates, taxes or other charges. In essence, each public entity seeking financing from the Bank must demonstrate sufficient approved revenue streams to cover debt service on any new loan from the Bank. As an exception, the Bank is permitted to grant emergency loans in those cases where the Board of Directors of the Bank determines that essential public services could be affected. These loans, however, are limited to an aggregate amount not to exceed 10% of the gross income of such public entity during the previous two fiscal years up to a limit of \$50 million. The Bank is also permitted to grant loans to public entities that are deemed to be not capable of repaying any principal or interest amount owed to bondholders or financial entities other than the Bank. Act No. 24 of 2014 is intended to impose fiscal discipline on the public entities, while preserving the Bank's balance sheet. In addition, such legislation (i) increases from \$550 million to \$2 billion the amount of the Bank obligations that can be guaranteed by the full faith and credit of the Commonwealth to provide the Bank with greater flexibility in its role of granting interim financing to public corporations and agencies (such guarantee can also be extended before September 1, 2014, at the discretion of the Treasury Secretary and the Bank, to certain other governmental obligations guaranteed by the Bank), (ii) grants the Bank the ability to exercise additional oversight over certain public funds deposited at private financial institutions and grants the Bank legal authority, subject to an entity's ability to request waivers under certain specified circumstances, to require such public funds (other than funds of the Legislative Branch, the Judicial Branch, the University of Puerto Rico, governmental pension plans, municipalities and certain other independent agencies) to be deposited at the Bank, which is expected to result in a more efficient management of public resources and (iii) provides a process through which OMB may assume, on behalf of the Commonwealth, the repayment from budgetary appropriations (commencing fiscal year 2017) of certain obligations owed by governmental agencies or public corporations to the Bank, up to a maximum amount of \$500 million.

The Bank's management's ability to implement additional initiatives and the terms thereof are subject to risks and uncertainties and may be adversely affected by subsequent credit rating downgrades and other adverse conditions in capital markets. The management of the Bank cannot provide any assurance that it will ultimately be successful in implementing any of such additional initiatives. The failure to implement these initiatives may have a material adverse effect on the financial condition of the Bank.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(5) Cash and Due from Banks, Federal Funds Sold, Deposits Placed with Banks, and Securities Purchased under Agreements to Resell

Custodial credit risk is the risk that, in the event of a financial institution failure, the Bank's deposits may not be returned to it. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. The Bank does not have a formal policy for custodial credit risk for cash accounts opened with commercial banks outside Puerto Rico. These accounts are opened only with well-capitalized financial institutions.

The Bank's policies for deposits placed with banks and federal funds sold establish maximum exposure limits for each institution based on the institution's capital, financial condition and credit rating assigned by nationally recognized rating agencies. Deposits placed with banks of approximately \$558 million mature within one month. Federal funds sold mature overnight and no collateral is required.

The table presented below discloses the level of custodial credit risk assumed by the Bank at June 30, 2013. As of June 30, 2013, \$692,362,448 of the depository bank balance of \$725,133,009 was uninsured and uncollateralized as follows:

	Carrying amount	Depository bank balance	Amount uninsured and uncollateralized
Cash and due from banks	\$ 77,658,083	17,126,992	3,723,307
Deposits placed with banks	558,008,310	558,006,017	538,639,141
Federal funds sold	150,000,000	150,000,000	150,000,000
Total	\$ 785,666,393	725,133,009	692,362,448

The carrying amount of securities purchased under agreements to resell at June 30, 2013, amounted to \$300 million. These agreements mature during the following month. The average amount outstanding during the year amounted to approximately \$367.7 million with the largest amount outstanding at any month-end amounting to approximately \$300 million. The Bank's investment policies establish minimum amounts of acceptable collateral, as well as the fair value of the securities in collateral. The fair value of the collateral is reviewed daily and the margin amount adjusted accordingly. The collateral was held by the Bank's custodian agent in the Bank's name.

(6) Investments

The Bank's investment policies allow management to purchase or enter into the following investment instruments:

- U.S. government and agencies obligations.
- Certificates of deposit and time deposits.
- Bankers' acceptances.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

- Obligations of the Commonwealth its public entities, and municipalities.
- Federal funds sold.
- Securities purchased under agreements to resell.
- World Bank securities.
- Mortgage-backed and asset-backed securities.
- Corporate debt, including investment contracts.
- External investment pools.
- Stock of corporations created under the laws of the United States of America 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 its equivalent by Moody's Investors Services.

The Bank's investment policies establish limitations and other guidelines on maturities and amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policies provide guidelines on the institutions with which investment transactions can be entered into. In addition, the Asset Liability Management Committee (ALCO) and the board of directors of the Bank will determine, from time to time, other transactions that the Bank may enter into.

Credit Risk – Credit risk is the risk that an issue or other counterparty to an investment will not fulfill its obligations. The Bank's investment policies provide that investment transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by Standard & Poor's or equivalent rating by Moody's Investors Service or Fitch Ratings (Fitch), depending on the type and maturity of the investment and the counterparty to the transaction. Any exceptions must be approved by the Bank's Board of Directors. The investment policies also provide that purchases and sales of investment securities shall be made using the delivery versus payment procedures.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Bank's investment policies also provide that the ALCO is responsible for implementing and monitoring the Bank's interest rate risk policies and strategies. The ALCO meets on a monthly basis to coordinate and monitor the interest rate risk management of interest sensitive assets and interest sensitive liabilities, including matching of their anticipated level and maturities, consistent with the Bank's liquidity, capital adequacy, risk and profitability goals set by the Bank's Board of Directors.

The following table summarizes the type and maturities of investments held by the Bank at June 30, 2013. Investments by type in any one issuer representing 5% or more of total investments of either the Bank or its blended component units have been separately disclosed. Expected maturities will differ

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

<u>Investment type</u>	<u>Within one year</u>	<u>After one to five years</u>	<u>After five to ten years</u>	<u>After ten years</u>	<u>Total</u>
U.S. Treasury notes	\$ 72,894,619	104,411,816	—	—	177,306,435
U.S. sponsored agencies notes:					
Federal National Mortgage Association ("FNMA")	—	153,776,590	379,198,852	—	532,975,442
Federal Home Loan Bank ("FHLB")	59,121,060	281,380,614	111,084,938	—	451,586,612
Federal Home Loan Mortgage Corporation ("FHLMC")	—	160,721,200	124,015,500	—	284,736,700
Federal Farm Credit Bank ("FFCB")	11,069,300	1,751,742	48,504,903	—	61,325,945
Mortgage and asset-backed securities:					
Government National Mortgage: Association ("GNMA")	—	958,239	—	131,331,476	132,289,715
FNMA	—	—	8,756,961	514,578,067	523,335,028
FHLMC	—	—	9,109	268,409,954	268,419,063
Interest-only strips	—	—	—	8,883,149	8,883,149
Other	—	177,960	—	74,103,701	74,281,661
Corporate debt:					
Caterpillar	7,565,255	—	—	—	7,565,255
United Parcel Services	2,050,320	—	—	—	2,050,320
General Electric	—	7,177,950	—	—	7,177,950
Wells Fargo	—	2,020,160	—	—	2,020,160
Walmart Stores	2,049,480	—	—	—	2,049,480
Andrew Mellon Foundation	—	3,109,200	—	—	3,109,200
Microsoft, Corp.	—	968,870	—	—	968,870
Amazon	—	2,486,725	—	—	2,486,725
International Business Machines	3,022,830	—	—	—	3,022,830
First Puerto Rico Family of Funds	74,920,000	—	—	—	74,920,000
Puerto Rico Tax Free Fund I	7,500,000	—	—	—	7,500,000
Puerto Rico Tax Free Fund II	7,500,000	—	—	—	7,500,000
Puerto Rico Tax Free Target Maturity Fund	7,500,000	—	—	—	7,500,000
Puerto Rico Fixed Income IV	7,500,000	—	—	—	7,500,000
Puerto Rico Fixed Income V	7,500,000	—	—	—	7,500,000
External investment pools:					
Fixed-income securities	—	118,861,959	—	5,412,893	124,274,852
Israel aid bonds	—	20,321,836	34,023,804	—	54,345,640
Nonparticipating investment contracts:					
Trinity Funding Co.	—	—	—	20,336,986	20,336,986
Citibank N.A.	—	—	—	17,628,800	17,628,800
Banco Popular de Puerto Rico	—	—	—	14,904,616	14,904,616
Banco Santander Puerto Rico	—	—	—	11,178,924	11,178,924
U.S. Municipal Notes	4,012,920	9,879,068	—	23,775,000	37,666,988
Total investments	<u>\$ 274,205,784</u>	<u>868,003,929</u>	<u>705,594,067</u>	<u>1,090,543,566</u>	2,938,347,346
External investment pools:					
Equity securities:					
Russell 1000 Growth Common Trust Fund					58,979,570
Global Opportunities Capital Appreciation Fund					14,211,583
Preferred securities/interest:					
Grupo Hima San Pablo					3,615,209
Other					404,495
Total					<u>\$ 3,015,558,203</u>

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Investments in fixed-income external investment pools had an average maturity of more than one year. These investments include \$118,861,959 invested in the Puerto Rico Government Investment Trust Fund, a government-sponsored pool, which is administered by the Bank. This pool is subject to regulatory oversight by the Commissioner of Financial Institutions of Puerto Rico. The fair value of the pool is the same as the value of the pool shares.

At June 30, 2013, the total amount of \$15,762,905 of the Bank's investment in corporate debt maturing over one year, bears fixed interest rate. Also, at June 30, 2013, approximately 13.4% of the Bank's investments in mortgage and asset-backed securities were held by trustees in connection with bonds issued by the Housing Finance Authority, the terms of which generally provide for early redemption of the bonds if the securities are early repaid.

During fiscal year 2013, the Bank invested in interest-only strips to maximize yields and as a protection against a rise in interest rates. These securities are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to increased prepayments by mortgages, which may result from a decline in interest rates. If interest rates decline, the value of interest-only strips declines. If interest rates increase, the value of interest-only strips increases.

During the year ended June 30, 2013, the Tourism Development Fund entered into an agreement with a third party to redeem its investment in class B preferred special interest in Desarrolladora Del Norte, S. en C. for \$32 million in cash and an \$8 million non-interest bearing promissory note. The non-interest bearing promissory note requires annual payments of \$800,000 through June 2023. Tourism Development Fund will condone annual payments if Desarrolladora Del Norte, S. en C. maintains its hotels operations in Puerto Rico with approximately 600 employees and complies with other requirements during the term of the contract. Management of the Tourism Development Fund understands that the collection of the promissory note is contingent on future events, therefore, the amounts under such promissory note will be recognized once they are collected.

During the year ended June 30, 2013, proceeds from sales and redemption of investments from all the proprietary funds amounted to approximately \$7 billion. Gross gains and losses on sale and redemption of investments amounted to approximately \$23.3 million and \$19.9 million, respectively. Purchases of investments during the year ended June 30, 2013, amounted to approximately \$4.8 billion.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

All of the Bank's investments in U.S. Treasury securities, mortgage-backed securities guaranteed by GNMA, and Israel Aid Bonds carry the explicit guarantee of the U.S. government. The credit quality ratings for investments in debt securities, excluding U.S. Treasury securities, mortgage-backed securities guaranteed by GNMA, and Israel Aid Bonds, at June 30, 2013, are as follows:

Securities type	Credit risk			Total
	Rating ⁽¹⁾			
	AAA to A-	BBB	B	
U.S. sponsored agencies notes:				
FNMA	\$ 532,975,442	—	—	532,975,442
FHLB	451,586,612	—	—	451,586,612
FHLMC	284,736,700	—	—	284,736,700
FFCB	61,325,945	—	—	61,325,945
Mortgage-backed and asset-backed securities:				
FNMA	523,335,028	—	—	523,335,028
FHLMC	268,419,063	—	—	268,419,063
Interest-only strips	8,883,149	—	—	8,883,149
Other	367,650	—	73,914,011	74,281,661
Corporate debt	142,870,790	—	—	142,870,790
External investment pools:				
Fixed-income securities	124,274,852	—	—	124,274,852
Nonparticipating investment contracts	37,965,786	11,178,924	14,904,616	64,049,326
U.S. Municipal Notes	37,666,988	—	—	37,666,988
Total	<u>\$ 2,474,408,005</u>	<u>11,178,924</u>	<u>88,818,627</u>	<u>2,574,405,556</u>

⁽¹⁾ Rating obtained from Standard & Poor's or equivalent rating by Moody's Investor Service or Fitch Ratings.

The credit quality ratings of nonparticipating investment contracts are based on the credit quality ratings at June 30, 2013, of the counterparties with whom these contracts are entered into. The credit quality ratings of the counterparties should follow the ratings required by the investment policies of the Bank.

As of June 30, 2013, the Bank had pledged investments and investment contracts to secure the following:

Payment of principal and interest on obligations issued by a blended component unit	\$ 291,297,208
Securities sold under agreements to repurchase	634,301,000

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(7) Loans Receivable and Allowance for Loan Losses

Loans at June 30, 2013 consist of the outstanding balance of credit facilities granted to the following (in thousands):

	GDB Operating Fund ⁽¹⁾	Tourism Development Fund	Housing Finance Authority	Development Fund	Total
Public corporations and agencies	\$ 6,889,134	—	—	—	6,889,134
Municipalities	2,212,481	—	—	—	2,212,481
Allowance for loan losses	(4,000)	—	—	—	(4,000)
Total loans to public sector	<u>9,097,615</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>9,097,615</u>
Private sector	39,935	376,361	360,014	21,259	797,569
Allowance for loan losses	(264)	(178,721)	(37,742)	(16,937)	(233,664)
Deferred fees	—	—	(26,430)	—	(26,430)
Total loans to private sector	<u>39,671</u>	<u>197,640</u>	<u>295,842</u>	<u>4,322</u>	<u>537,475</u>
Balance – end of year	<u>\$ 9,137,286</u>	<u>197,640</u>	<u>295,842</u>	<u>4,322</u>	<u>9,635,090</u>

⁽¹⁾ Excluding loans to component units.

(a) Public Corporations and Agencies

Loans to the Commonwealth and its public entities amounted to approximately \$6.9 billion or 48% of the Bank's government-wide total assets as of June 30, 2013. Loans to the Commonwealth and its public entities typically include working capital lines of credit payable from short-term tax and revenue anticipation notes issued by the Commonwealth, interim financing of capital improvements payable from Commonwealth's general obligation bonds or revenue bonds issued by the corresponding agency and, in recent years, loans to finance the Commonwealth's budget deficit payable from COFINA, uncollected taxes and annual appropriations made by the Legislature.

The loans for capital improvements generally are construction loans and are repaid from the proceeds of future bond issuances of the respective public entities. Such loans may, however, also be repaid from the revenues of such public entities, from loans provided by sources other than the Bank, from federal grants, and from the sale of assets of such public entities. The amount of outstanding loans from the Bank to the public entities fluctuates annually, depending upon the capital program needs of the public entities, the timing and level of their capital expenditures, and their ability to gain access to the long-term capital markets. The participation of certain of the Commonwealth and its public entities in the bond market has been delayed waiting for the credit rating of such entities to improve or for more favorable market conditions.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The Commonwealth's recurring expenditures have exceeded its recurring revenues during the past fourteen years and its credit ratings have been lowered. In addition, many of the Commonwealth's public entities have had losses from operations during the past years. These shortfalls were partially covered with loans from the Bank and other nonrecurring revenues. The collectability of these loans may be affected by budgetary constraints, the fiscal situation, and the credit rating of the Commonwealth, its public entities, and their ability to generate sufficient funds from taxes, charges and/or bond issuances. Continuance of and/or significant negative changes in these factors may affect the ability of the Commonwealth and its public entities to repay their outstanding loan balances with the Bank and accordingly, may have an adverse impact on the Bank's financial condition, liquidity, funding sources, and results of operations.

For the year ended June 30, 2013, disbursements and collections of public sector loans with future bond issuances as source of repayment amounted to approximately \$1.3 billion and \$258 million, respectively. Public sector loans with Commonwealth appropriations as source of repayment had disbursements and collections amounting to approximately \$474 million and \$328 million, respectively during the year ended June 30, 2013. Public sector loans with operating income as source of repayment had disbursements and collections amounting to approximately \$112 million and \$22 million, respectively during the year ended June 30, 2013.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

At June 30, 2013, loans to public corporations and agencies of the Commonwealth are repayable from the following sources (in thousands and segregated by the reporting category of each borrower as disclosed in the Commonwealth's audited financial statements of June 30, 2012):

	Source of repayment (in thousands)					Percentage of Government wide total assets
	Bond issuances	Operating revenue	Legislative appropriations	Other	Total	
Borrowers described as primary government in the Commonwealth's financial statements as of June 30, 2012:						
Treasury Department	\$ 662,349	98,000	825,689	—	1,586,038	11.08%
Public Building Authority	268,967	—	67,311	—	336,278	2.35
Office of Management and Budget	—	—	212,131	—	212,131	1.48
Department of Education	—	—	110,365	—	110,365	0.77
Farm Services Administration	—	—	92,606	—	92,606	0.65
Others	—	33,166	314,771	—	347,937	2.43
Total	<u>931,316</u>	<u>131,166</u>	<u>1,622,873</u>	<u>—</u>	<u>2,685,355</u>	<u>18.76</u>
Borrowers described as discretely presented in the Commonwealth's financial statements as of June 30, 2012:						
Puerto Rico Highways and Transportation Authority	2,045,130	—	—	—	2,045,130	14.28
Special Communities Perpetual Trust	—	—	360,403	—	360,403	2.52
Puerto Rico Medical Services Administration	—	—	273,344	—	273,344	1.91
Puerto Rico Ports Authority	—	—	220,391	—	220,391	1.54
Port of the Americas Authority	—	—	215,389	—	215,389	1.50
Others	12,918	147,607	742,011	17,472	920,008	6.43
Total	<u>2,058,048</u>	<u>147,607</u>	<u>1,811,538</u>	<u>17,472</u>	<u>4,034,665</u>	<u>28.18</u>
Other borrowers affiliated to the Commonwealth not included in the Commonwealth's financial statements as of June 30, 2012:						
Municipal Revenue Collection Center	—	128,493	26,820	—	155,313	1.08
Others	—	—	13,801	—	13,801	0.10
Total	<u>—</u>	<u>128,493</u>	<u>40,621</u>	<u>—</u>	<u>169,114</u>	<u>1.18</u>
Total Commonwealth and public entities	<u>\$ 2,989,364</u>	<u>407,266</u>	<u>3,475,032</u>	<u>17,472</u>	<u>6,889,134</u>	<u>48.12%</u>

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

During fiscal year 2013, the Bank received \$65.1 million, \$97.9 million and \$62.4 million of appropriations to repay principal of and interest on public sector loans whose repayment source was originally from COFINA, from future issuances of Commonwealth's general obligations bonds, and other legislative appropriations, respectively. The Commonwealth's general fund budget for fiscal year 2014 includes \$65.7 million, \$103.1 million, and \$122.5 million of appropriations to repay principal of and interest on public sector loans whose repayment source was originally from COFINA, from future issuances of Commonwealth's general obligations bonds, and other legislative appropriations, respectively. These appropriations are based on payment schedules proposed by the Bank, which are mostly based on a period of amortization of 30 years each, at contractual interest rates. The Bank will annually submit to the OMB, to be included in the Commonwealth's budget for legislative approval in each subsequent fiscal year, an amount established in the payment schedules with the terms stated above. The Bank expects that future appropriations will be approved by the Legislature to comply with such schedules. However, there can be no assurance that the Director of OMB will include an amount for loan repayments in the Commonwealth's budget, and that the Legislature will appropriate sufficient funds in the future to cover all amounts due to the Bank on these loans.

As of June 30, 2013, there are five loans amounting to approximately \$98 million that the appropriations from the Commonwealth are not based on enacted legislation. However, management is of the opinion that not having an enacted legislation does not bear additional collectability risk based on the history of appropriations approved by OMB and the Legislature. Appropriations have been included in the fiscal year 2014 budget to repay the scheduled principal and interest of those five loans.

Total public sector loans and undisbursed loan commitments that were refinanced to extend maturity dates during the period ended June 30, 2013, amounted to approximately \$3.8 million. No other modifications (i.e. interest rate reductions, etc.) were made during the year.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

At June 30, 2013, loans to the Commonwealth and its public entities that its main source of repayment has changed are the following (in thousands and segregated by the reporting category of each borrower as disclosed in the Commonwealth's audited financial statements of June 30, 2012):

	Change in source of repayment (in thousands)					
	Bond issuances - previously operating revenue	Legislative appropriations - previously Common wealth's general obligation bond issuances	Legislative appropriations - previously COFINA	Legislative appropriations - previously operating income	Others	Total
Borrowers described as primary government in the Commonwealth's financial statements as of June 30, 2012:						
Treasury Department	\$ —	196,887	465,443	—	—	662,330
Public Building Authority	52,871	—	67,177	—	—	120,048
Department of Education	—	4,801	105,564	—	—	110,365
Farm Services Administration	—	—	47,181	45,425	—	92,606
Others	—	213,562	22,073	289	—	235,924
Total	<u>52,871</u>	<u>415,250</u>	<u>707,438</u>	<u>45,714</u>	<u>—</u>	<u>1,221,273</u>
Borrowers described as discretely presented in the Commonwealth's financial statements as of June 30, 2012:						
Puerto Rico Highways and Transportation Authority	468,128	—	—	—	16,422	484,550
Special Communities Perpetual Trust	—	360,403	—	—	—	360,403
Puerto Rico Ports Authority	—	—	—	215,389	—	215,389
Others	—	345,340	41,653	—	6,634	393,627
Total	<u>468,128</u>	<u>705,743</u>	<u>41,653</u>	<u>215,389</u>	<u>23,056</u>	<u>1,453,969</u>
Other borrowers affiliated to the Commonwealth not included in the Commonwealth's financial statements as of June 30, 2012:						
Municipal Revenue Collection Center	—	—	26,820	—	—	26,820
Others	—	—	13,801	—	—	13,801
Total	<u>—</u>	<u>—</u>	<u>40,621</u>	<u>—</u>	<u>—</u>	<u>40,621</u>
Total Commonwealth and public entities \$	<u><u>520,999</u></u>	<u><u>1,120,993</u></u>	<u><u>789,712</u></u>	<u><u>261,103</u></u>	<u><u>23,056</u></u>	<u><u>2,715,863</u></u>

Starting in fiscal year 2010, as part of its risk management activities and as a condition to provide financing support to certain public entities, the Bank has entered into fiscal oversight agreements with such public entities. The agreements require the public entities, among other, to implement a comprehensive expense reduction program, including certain fiscal oversight controls, subject to laws and existing agreements of the public entities, designed to minimize future tariff increases to households and the private sector, and to protect and improve the credit rating of the public entities, so that the public entities may obtain adequate financing to fund its capital expenditure requirements and to operate its infrastructure in an efficient and reliable manner and in compliance with applicable laws and regulations. The Bank's agreement to provide current financing and any future financing is

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

expressly conditioned upon the public entities' compliance with the covenants established in the fiscal oversight agreement and the Bank's right to monitor and enforce such compliance. These agreements will be in effect until the public entities have regained a level of financial stability and are able to secure long-term financing that will result in the continued stability of the public entities' operations and financial condition. As of June 30, 2013, management of the Bank determined that all public entities have complied with the material terms and conditions of their respective agreements.

A public sector loan amounting to approximately \$26.9 million as of June 30, 2013, was identified as delinquent and classified as nonaccrual. Interest income that would have been recorded if such nonaccrual loan had been accruing in accordance with its original terms was approximately \$1.6 million in fiscal year 2013. No interest was collected on this loan during the year ended June 30, 2013.

As of June 30, 2013, the Bank has extended various credit facilities to the Puerto Rico Highways and Transportation Authority (HTA) for, among other things, capital improvement programs, working capital, debt service and collateral posting requirements. The outstanding balance of such facilities amounts to approximately \$2 billion, including accrued interest of \$145 million, which represent 14% and 83%, of the Bank's total governmental-wide assets and net position, respectively, at June 30, 2013.

The Bank, in its ordinary course of business, provides interim lines of credit to public entities like HTA. These lines of credit have historically been repaid from bond issuances of public entities, once they regain or have access to the capital markets. HTA has reported net operating losses during each of the four fiscal years in the period ended June 30, 2013 and, as a result, the Bank has been partially financing its operations through credit facilities. In fiscal year 2010, HTA entered into a fiscal oversight agreement with the Bank, whereby the Bank, among other things, imposes conditions on the extensions of credit to HTA and continually monitors its finances. During February 2014, all the rating agencies, downgraded the credit rating of HTA to a noninvestment grade classification.

Managements of HTA and the Bank are working with various alternatives for HTA to gain access to the bond capital market, including, among others, a new trust indenture, revenue increasing measures, and expense reduction measures. As part of the measures taken by the Commonwealth to reduce the credit exposure the Bank has on HTA, Acts No. 30 and 31 were enacted effective July 1, 2013, and established an increase to the cigarettes and other tobacco derivatives tax. On June 25, 2013, the Act No. 30 was created by the Commonwealth of Puerto Rico and assigned to HTA all the revenues generated through the vehicle license fee. Also, the Act No. 31 was created by the Commonwealth to increase the petroleum tax revenues from \$3.00 to \$9.00 per petroleum barrel and the assignment of \$20 million annually from cigarettes taxes. The revenues obtained from these taxes will be used to pay outstanding loans with the Bank.

During August 2013, HTA issued the 2013A bond anticipation notes amounting to \$400 million. The proceeds from the bond anticipation notes were used to pay outstanding loans held by HTA with the Bank. In addition to the above, subsequent to June 30, 2013, the Bank has disbursed and collected approximately \$89 million and \$69.5 million, respectively related to loans of HTA.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Although management of the Bank anticipates that no losses of principal and interest will be incurred by the Bank with respect to most loans outstanding to the public entities at June 30, 2013, there can be no assurance that the Director of OMB will include amounts for loan repayments in the Commonwealth's budget, and that the Legislature will appropriate sufficient funds in the future to cover all amounts due to the Bank by the Commonwealth or public entities requiring the Commonwealth's support, or that the proceeds from any future bond or note issuances by COFINA or certain public entities, will be sufficient to cover the outstanding amount due to the Bank at June 30, 2013.

(b) Municipalities Loans

Loans to municipalities amounted to approximately \$2.2 billion or 15% of the Bank's government-wide total assets at June 30, 2013. For the year ended June 30, 2013, municipal sector loan disbursements and collections amounted to approximately \$185 million and \$169 million, respectively.

At June 30, 2013, loans to municipalities are repayable from the following sources (in thousands):

	Principal	Percentage of government wide total assets
Repayment source:		
Collections of property tax	\$ 1,402,099	9.79%
Collections of municipal sales and use tax	551,789	3.85
Operating revenues and other	258,593	1.81
Total	\$ 2,212,481	15.45%

These loans include approximately \$1.4 billion at June 30, 2013, which are collateralized by a pledge of a portion of property tax assessments of each municipality. Loans pledged with property tax assessments include bonds and notes issued by Puerto Rico municipalities which are originated by the Bank as bridge financing until such financings can be packaged and securitized.

Loans to municipalities include \$551.8 million at June 30, 2013, which are collateralized by a pledge of a portion of the municipal sales tax, which is deposited in special accounts with the Bank for the purpose of granting such loans to municipalities. The funds available in such accounts increase the borrowing capacity of the corresponding municipality.

Loans to municipalities include \$258.6 million at June 30, 2013, which were provided mainly as interim loans to finance capital expenditures that are payable from revenues to be generated from a specific revenue generating project associated with the loan or to cover operating losses. Once operating loans are approved and if the municipality is not servicing the debt with its own funds, the Bank informs the Municipal Revenue Collection Center (CRIM for its Spanish acronym) in order to withhold property taxes revenues and remit them directly to the Bank before they are distributed to

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

the municipalities. These loans include approximately \$7.2 million which were previously payable from future issuances of the Commonwealth's general obligations and are currently payable from legislative appropriations.

Municipality loans amounting to approximately \$1.5 million as of June 30, 2013, were identified as delinquent. No interest was collected on these loans during the year ended June 30, 2013.

(c) ***Private Sector Loans***

Loans to the private sector include the outstanding principal balance of credit facilities granted by the Bank, the Tourism Development Fund and the Development Fund to private enterprises in Puerto Rico, the activities of which are deemed to further the economic and tourism development of Puerto Rico. Loans to the private sector also include the outstanding principal balance of mortgage loans granted to low and moderate-income families for the acquisition of single-family housing units and to developers of low and moderate-income multifamily housing units in Puerto Rico. These credit facilities, net of allowance for loan losses, amounted to approximately \$537 million at June 30, 2013, of which approximately \$296 million are mortgage loans for low and moderate-income housing units and approximately \$198 million are for tourism projects.

Private sector loans classified as nonaccrual amounted to approximately \$436 million at June 30, 2013. Interest income that would have been recorded if these loans had been performing in accordance with their original terms was approximately \$12.3 million in 2013.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The following is a summary of private sector loans considered to be impaired as of June 30, 2013, and the related interest income for the year then ended (in thousands):

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Development Fund	Total
Recorded investment in impaired loans:					
Not requiring an allowance for loan losses	\$ 106	3,286	—	—	3,392
Requiring an allowance for loan losses	264	41,204	369,864	21,259	432,591
Total recorded investment in impaired loans	<u>\$ 370</u>	<u>44,490</u>	<u>369,864</u>	<u>21,259</u>	<u>435,983</u>
Related allowance for loan losses	\$ 264	30,668	178,721	16,937	226,590
Average recorded investment in impaired loans	376	58,389	396,708	19,317	474,790
Interest income recognized on impaired loans	—	—	—	—	—

The following is a summary of the activity in the allowance for loan losses for the year ended June 30, 2013 (in thousands):

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Development Fund	Total
Balance – beginning of year	\$ 4,264	39,191	239,947	10,700	294,102
Provision (credit) for loan losses		(755)	23,774	6,237	29,256
Write-offs	—	(1,196)	(85,000)	—	(86,196)
Recoveries	—	502	—	—	502
Balance – end of year	<u>\$ 4,264</u>	<u>37,742</u>	<u>178,721</u>	<u>16,937</u>	<u>237,664</u>

During the year ended June 30, 2013, the Tourism Development Fund sold a loan receivable to a third party for \$50 million. Cash collected during the period ended June 30, 2013, amounted to \$40.3 million. The remainder of the amount due under the sales contract (\$7.9 million) will be recognized as income when collected as such amount is contingent upon certain action on the part of the Tourism Development Fund. Thus, and based on the contingent nature of this portion of the sales contract, the Bank has reflected as an account receivable as of June 30, 2013 only the amount

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

actually collected after fiscal year end (\$1.8 million) but before the issuance of these financial statements. Cash collected on such sale is presented in the statement of cash flows as part of the principal collected on other than housing program loans. During February 2014, a loan of the Tourism Development Fund was sold to a third party developer for \$87.5 million.

(8) Due from Federal Government

The Housing Finance Authority, as a public housing agency, is authorized to administer the U.S. Housing Act Section 8 Programs in Puerto Rico. The revenues and expenses of such federal financial assistance are accounted for as a major governmental fund under the HUD Programs fund. Revenues and expenditures related to the administration of the U.S. Housing Act Section 8 Programs amounted to approximately \$140.8 million during the year ended June 30, 2013. This amount includes approximately \$5.1 million of administrative fees for services performed as contract administrator, which are reimbursed by HUD. As of June 30, 2013, the amounts due from federal government under the HUD Programs fund amounted to approximately \$1.1 million.

During the year ended June 30, 2013, the Housing Finance Authority expended approximately \$25 million of HOME Program funds, of which approximately \$9.9 million are due from the federal government as of June 30, 2013. In accordance with the Housing Finance Authority's accounting policies, the Housing Finance Authority has deferred the recognition of revenue of approximately \$6.9 million due from the federal government as such amounts are not considered to be available. This amount has been recorded as deferred revenue in the accompanying balance sheet – governmental funds.

The New Secure Housing Program (the NSH Program) constituted an inter-governmental effort to provide long term hazard mitigation assistance to the Commonwealth by providing funding for relocation of eligible participants who were affected by Hurricane Georges in 1998 or who lived in hazard-prone areas under the FEMA Hazard Mitigation Grant Program (HMGP). Through a series of collaborative agreements, the Office of the Governor's Authorized Representative (the GAR) was named the grantee, the Puerto Rico Department of Housing (the DOH) was named the sub-grantee, and the Housing Finance Authority was named the administrator of the NSH Program.

Under the NSH Program, the Housing Finance Authority was responsible for administering the NSH Program, including contracting, supervising and paying the designers, inspectors, and legal services needed for the NSH Program. The Housing Finance Authority also provided all funding for the NSH Program through a \$67 million nonrevolving line of credit with the Bank. The DOH was responsible for land acquisitions, auctioning projects, awarding construction contracts, qualifying participants, and selling housing units to eligible participants.

Under the terms of the grant, the construction of, and relocation of participants into new secure housing facilities was to be completed by December 31, 2007. In addition, FEMA would reimburse 75% of the allowable costs of the NSH Program. Funds collected under the NSH Program, since its inception, amounted to approximately \$113 million and are subject to compliance audits under OMB Circular A-133 and federal granting agencies audits.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

In April 2007, FEMA discontinued reimbursing the Housing Finance Authority's allowable costs based on the NSH Program's noncompliance with the scheduled dates for construction activities and case management. The DOH requested various extensions and reconsiderations the last one up to June 30, 2010 and FEMA granted such requests.

Although significant progress was made through June 30, 2010, in the construction activities and in the case management of the NSH Program, the Housing Finance Authority was not able to fully comply with the terms of the extensions granted by FEMA. On September 30, 2011, the Housing Finance Authority provided FEMA and the GAR, the NSH Program's closeout documentation which was reviewed by FEMA.

On January 30, 2012, the Housing Finance Authority and the DOH entered into a transition agreement by which the DOH would assume its obligations as the NSH Program sub-grantee and project owner, including vacant property dispositions, open space monitoring and other related matters. The Housing Finance Authority will continue to assume the amounts payable under the \$67 million nonrevolving line of credit with Bank, until such debt can be assumed by the Commonwealth. The DOH would prospectively assume, without recourse, any additional funds that might be requested by FEMA for events of noncompliance, including related costs.

Based on all these facts and that no reimbursements have been received from FEMA since April 2007, management has decided to establish an allowance for the \$26 million due from FEMA at June 30, 2013.

(9) Real Estate Available for Sale

Real estate available for sale at June 30, 2013, consisted of the following:

	Enterprise Funds		
	GDB Operating Fund	Housing Finance Authority	Total
Land	\$ —	8,880,000	8,880,000
Residential (1-4 units)	—	15,027,613	15,027,613
Commercial	80,673,321	—	80,673,321
Valuation allowance	(25,995,052)	(12,990,815)	(38,985,867)
Total real estate available for sale	\$ 54,678,269	10,916,798	65,595,067

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The following is a summary of the valuation allowance activity for the year ended June 30, 2013:

	GDB Operating Fund	Housing Finance Authority	Total
Balance – beginning of year	\$ 23,016,563	11,272,729	34,289,292
Provision for possible losses	2,978,489	1,791,436	4,769,925
Write-offs	—	(73,350)	(73,350)
Balance – end of year	<u>\$ 25,995,052</u>	<u>12,990,815</u>	<u>38,985,867</u>

During fiscal year 2009, the Bank entered into an interagency agreement with a public entity of the Commonwealth whereby the Bank received several properties with appraised values (based on appraisals made near the transaction date) of \$155.9 million in lieu of payment of a loan whose principal balance and accrued interest receivable amounted to \$144.2 million at December 30, 2008. The interagency agreement provides that the agency of the Commonwealth shall transfer to the Bank additional properties to cover any deficiency in the properties values during a period of five years. On November 20, 2013, the agreement was extended until December 30, 2018.

Since 2009, management of the Bank has been able to: (i) sell certain of the properties, (ii) obtained appraisals reports of the properties, which had resulted in a decrease in the appraised values of certain of such properties, net of estimated selling costs, and (iii) collect a portion of the deficiency that results from losses on sales or the fair value reductions. Based on this, as of June 30, 2013, management maintains approximately \$82.2 million of other receivables from the Commonwealth’s agency at June 30, 2013, which have been recorded as a reduction of the carrying value of the properties (included within real estate available for sale in the accompanying government-wide statement of net position).

Furthermore, the Legislature included \$7.5 million in the 2013-14 fiscal year general fund budget (through its Joint Resolution No. 17) which provides for the current payment of this account receivable. The Legislature is not obligated to authorize such appropriations in the subsequent fiscal years. However, should the Legislature fail to include such amount in fiscal years subsequent to June 30, 2014, the management of the Bank is of the opinion that it will receive properties or cash to cover such deficiency and, accordingly, believes that no valuation allowance on the receivable from the Commonwealth’s agency is needed at June 30, 2013.

The Housing Finance Authority maintained a line of credit of \$50 million with a commercial bank to provide funds to the Department of Housing to finance the operations of the “Revitalización de Santurce” Program. The project’s objective was to rehabilitate and redevelop the Santurce sector in the Municipality of San Juan through purchase and expropriations of properties for redevelopment of commercial and residential projects. The Housing Finance Authority entered into a collaborative agreement with the Department of Housing under which it would finance the property acquisition efforts under the Program. The funds for the Department of Housing’s property expropriation efforts of real property were withdrawn from the line of credit. Once the property was acquired, the Department of Housing would immediately transfer ownership to the Housing Finance Authority to collateralize the line of credit. The Department of

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Housing subsequently would enter into purchase agreements with developers that met the Program's underlying objectives. The proceeds of the sale of the properties to the developers would serve to repay the line of credit. However, due to the general real estate market conditions and lack of financing the projects under which conditioned purchase agreements were subscribed were no longer feasible. In turn, the Housing Finance Authority repaid the outstanding balance and retained title to the properties held in trust in lieu of payment amounting to \$8,880,000 which are included as part of real estate available for sale in the accompanying statement of net position and balance sheet – proprietary funds.

(10) Capital Assets

Capital assets activity for the year ended June 30, 2013, was as follows:

	Governmental activities			Ending balance
	Beginning balance	Additions	Reductions/ reclassifications	
Capital assets:				
Information systems	\$ 66,329	—	—	66,329
Office furniture and equipment	33,967	3,107		37,074
Vehicles	66,135	—	—	66,135
Total capital assets	166,431	3,107	—	169,538

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

	Governmental activities			
	Beginning balance	Additions	Reductions/ reclassifications	Ending balance
Less accumulated depreciation and amortization for:				
Information systems	\$ (52,930)	(13,377)	—	(66,307)
Office furniture and equipment	(28,335)	(3,690)	—	(32,025)
Vehicles	(66,132)	—	—	(66,132)
Total accumulated depreciation	<u>(147,397)</u>	<u>(17,067)</u>	<u>—</u>	<u>(164,464)</u>
Capital assets governmental activities – net	\$ <u>19,034</u>	<u>(13,960)</u>	<u>—</u>	<u>5,074</u>
	Business type – activities			
	Beginning balance	Additions	Reductions/ reclassifications	Ending balance
Capital assets not being depreciated – land:				
Land	\$ 11,725,000	—	(8,880,000)	2,845,000
Land under development	73,290,540	13,882,157	—	87,172,697
Total capital assets not being depreciated	<u>85,015,540</u>	<u>13,882,157</u>	<u>(8,880,000)</u>	<u>90,017,697</u>
Capital assets being depreciated:				
Building	8,988,048			8,988,048
Leasehold improvements	4,715,152	16,375	(48,208)	4,683,319
Information systems	4,222,025	546,725	(43,661)	4,725,089
Office furniture and equipment	2,741,206	145,754	(121,107)	2,765,853
Software	2,450,076	89,728	(40,526)	2,499,278
Vehicles	217,115	40,734	—	257,849
Total capital assets being depreciated	<u>23,333,622</u>	<u>839,316</u>	<u>(253,502)</u>	<u>23,919,436</u>
Less accumulated depreciation and amortization for:				
Building	(2,584,064)	(224,701)	—	(2,808,765)
Leasehold improvements	(2,617,841)	(494,274)	—	(3,112,115)
Information systems	(2,742,766)	(693,677)	43,661	(3,392,782)
Office furniture and equipment	(2,267,789)	(213,411)	121,107	(2,360,093)
Software	(1,731,515)	(433,219)	40,526	(2,124,208)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

	Business type – activities			Ending balance
	Beginning balance	Additions	Reductions/ reclassifications	
Vehicles	\$ (205,779)	(11,166)	—	(216,945)
Total accumulated depreciation and amortization	(12,149,754)	(2,070,448)	205,294	(14,014,908)
Total capital assets being depreciated – net	11,183,868	(1,231,132)	(48,208)	9,904,528
Capital assets business type activities – net	\$ 96,199,408	12,651,025	(8,928,208)	99,922,225
Total capital assets – net				\$ 99,927,299

Land under development represents property owned by the Bank that is being developed for future government benefit. Specifically, as part of its functions of furthering the economic development of Puerto Rico, the Bank is developing the infrastructure and public spaces of the “Comunidad Río Bayamón Norte” as per the Master Plan approved by the Puerto Rico Planning Board. The infrastructure development includes the construction of the roads, sidewalks, electric, sanitary and sewer systems and an urban park with recreational areas, clubhouse and tennis courts. As part of the development, the Bank is contributing to certain offsite improvements with the Puerto Rico Electric and Power Authority, the Puerto Rico Aqueduct and Sewer Authority and the Puerto Rico Highways and Transportation Authority. The development will have access to “Tren Urbano Jardines” Station. Accounts payable related to land under development as of June 30, 2013, amount to approximately \$10.3 million.

(11) Deposits

Deposits consist predominantly of interest-bearing demand accounts, special government deposit accounts, and time deposits from the Commonwealth, its agencies, instrumentalities, and municipalities. Interest expense on these deposits amounted to approximately \$48 million during fiscal year 2013.

(12) Securities Sold under Agreements to Repurchase

The following is selected information concerning securities sold under agreements to repurchase:

Carrying amount at June 30, 2013	\$ 634,301,000
Maximum amount outstanding at any month-end	1,359,396,959
Average amount outstanding during the year	801,512,614
Weighted average interest rate for the year	0.54%
Weighted average interest rate at year-end	0.15

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The following summarizes the activity of securities sold under agreements to repurchase for the year ended June 30, 2013:

	Beginning balance	Issuances	Maturities	Ending balance
GDB Operating Fund	\$ 884,484,334	30,009,620,496	30,259,803,830	634,301,000

All sales of investments under agreements to repurchase are for fixed terms. In investing the proceeds of securities sold under agreements to repurchase, the Bank's policy is for the term to maturity of investments to be on or before the maturity of the related repurchase agreements. At June 30, 2013, the total amount of securities sold under agreements to repurchase mature within one year.

(13) Bonds, Notes, and Mortgage-Backed Certificates Payable, and Other Liabilities

The activity of bonds payable and other borrowed funds for the year ended June 30, 2013, is as follows:

	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Governmental activities – commonwealth appropriation bonds and notes – note payable – AHMSP Act. No. 124	\$ 3,500,735	—	—	3,500,735	—
Add unamortized premium	74,656	—	3,728	70,928	—
Less deferred loss on refunding	(148,525)	—	(7,426)	(141,099)	—
Total governmental activities	\$ 3,426,866	—	(3,698)	3,430,564	—

	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Business-type activities: GDB Operating Fund:					
Remarketed Refunding Bonds	\$ 267,000,000	—	—	267,000,000	—
Senior Notes 2006 Series B	302,695,000	—	(66,205,000)	236,490,000	68,785,000
Senior Notes 2006 Series C	81,960,000	—	—	81,960,000	—
Senior Notes 2010 Series A	433,702,000	—	—	433,702,000	—
Senior Notes 2010 Series B	151,259,000	—	—	151,259,000	—
Senior Notes 2010 Series C	217,715,000	—	—	217,715,000	—
Senior Notes 2010 Series D	96,411,000	—	—	96,411,000	—
Senior Notes 2011 Series A	70,000,000	—	—	70,000,000	70,000,000
Senior Notes 2011 Series B	650,000,000	—	—	650,000,000	250,000,000
Senior Notes 2011 Series C	153,000,000	—	(153,000,000)	—	—
Senior Notes 2011 Series D	100,300,000	—	(100,300,000)	—	—
Senior Notes 2011 Series H	1,399,045,000	—	—	1,399,045,000	—

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Senior Notes 2011 Series I	\$ 397,935,000	—	—	397,935,000	—
Senior Notes 2012 Series A	1,000,000,000	—	—	1,000,000,000	—
Add (deduct) unamortized premium (discount)	(6,020,249)	—	169,220	(5,851,029)	126,392
Total senior notes	5,315,001,751	—	(319,335,780)	4,995,665,971	388,911,392
Notes payable Scotiabank	250,000,000	500,000,000	(750,000,000)	—	—
Total GDB Operating Fund	5,565,001,751	500,000,000	(1,069,335,780)	4,995,665,971	388,911,392
Housing Finance Authority: Mortgage Trust III	166,025,002	—	(18,175,000)	147,850,002	23,530,000
Revenue bonds:					
Single Family Mortgage Revenue Bonds – Portfolio XI	17,555,000	—	(955,000)	16,600,000	325,000
Homeownership Mortgage Revenue Bonds 2000	41,370,000	—	(41,370,000)	—	—
Homeownership Mortgage Revenue Bonds 2001	42,275,000	—	(42,275,000)	—	—
Homeownership Mortgage Revenue Bonds 2003	20,180,000	—	(20,180,000)	—	—
Mortgage-Backed Certificates – 2006 Series A	102,929,440	—	(9,466,397)	93,463,043	11,110,260
Total revenue bonds	224,309,440	—	(114,246,397)	110,063,043	11,435,260
Subtotal	390,334,442	—	(132,421,397)	257,913,045	34,965,260
Notes payable:					
GDB (operations and administration)	3,129,245	99,301,562	(102,430,807)	—	—
Special obligation notes (Home Purchase Stimulus Program)	46,990,000	30,475,000	(1,020,400)	76,444,600	—
Special obligation notes (Third Party Origination Program)	—	38,000,000	(8,223,045)	29,776,955	866,173
Plus unamortized premium	423,605	—	(54,280)	369,325	—
Less unaccreted discount and deferred amount on refunds	(69,825,611)	(18,313,856)	14,932,750	(73,206,717)	—
Total Housing Finance Authority	371,051,681	149,462,706	(229,217,179)	291,297,208	35,831,433
Tourism Development Fund:					
Participation agreement payable	25,205,556	—	(866,667)	24,338,889	866,664
Notes payable to GDB	406,649,968	15,108,053	(90,000,000)	331,758,021	246,758,048
Total Tourism Development Fund	431,855,524	15,108,053	(90,866,667)	356,096,910	247,624,712
Total	6,367,908,956	664,570,759	(1,389,419,626)	5,643,060,089	672,367,537

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Less intrafund eliminations	\$ (409,779,213)	(114,409,615)	192,430,807	(331,758,021)	(246,758,048)
Total business-type activities	\$ <u>5,958,129,743</u>	<u>550,161,144</u>	<u>(1,196,988,819)</u>	<u>5,311,302,068</u>	<u>425,609,489</u>

The annual debt service requirements to maturity, including principal and interest, for long-term debt, (excluding notes payable by component units to the Bank) as of June 30, 2013, are as follows:

	<u>GDB Operating Fund</u>			
	<u>Business-type activities</u>			
	<u>Principal</u>	<u>Interest</u>	<u>Interest subsidy ⁽¹⁾</u>	<u>Total</u>
Years ending June 30:				
2014	\$ 388,785,000	218,029,018	(4,875,949)	213,153,069
2015	480,770,000	212,339,143	(4,984,359)	207,354,784
2016	876,040,000	184,745,576	(4,984,359)	179,761,217
2017	269,195,000	156,495,318	(4,984,359)	151,510,959
2018	237,490,000	138,216,665	(4,984,359)	133,232,306
2019-2023	1,834,002,000	367,062,194	(24,921,794)	342,140,400
2024-2027	915,235,000	57,431,541	(11,214,807)	46,216,734
Total	\$ <u>5,001,517,000</u>	<u>1,334,319,455</u>	<u>(60,949,986)</u>	<u>1,273,369,469</u>

⁽¹⁾ The GDB Senior Notes Series 2010 B and 2010 D were issued as Build America Bonds. The Bank will receive a subsidy payment from the federal government equal to 35% of the amount of each interest payment. Subsidy payment from November 1, 2013 will be subject to sequestration of 8.7% from IRS due to adjustments to the Federal Government budget. As of June 30, 2013, total receivable from federal government amounted to approximately \$806,000.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

	Housing Finance Authority			
	Governmental activities		Business-type activities	
	Principal	Interest	Principal	Interest
Years ending June 30:				
2014	\$ —	195,620	35,831,433	6,770,226
2015	—	195,620	37,090,747	6,253,210
2016	103,049	192,958	18,540,658	5,772,175
2017	83,595	190,022	34,261,408	5,317,675
2018	86,478	186,839	21,002,461	4,883,610
2019-2023	487,614	874,753	93,235,469	29,256,638
2024-2028	1,231,900	735,218	41,950,439	33,081,615
2029-2033	1,508,099	98,086	32,063,033	22,098,247
2034-2038	—	—	28,640,881	12,614,904
2039-2043	—	—	21,518,071	2,565,785
Total	\$ 3,500,735	2,669,116	364,134,600	128,614,085

	Tourism Development Fund (2)	
	Business-type activities	
	Principal	Interest
Years ending June 30:		
2014	\$ 866,664	708,481
2015	866,667	682,757
2016	866,667	657,033
2017	866,667	631,309
2018	866,667	605,585
2019	20,005,557	—
Total	\$ 24,338,889	3,285,165

(2) Debt service requirements of this variable-rate debt assume that the interest rate effective at June 30, 2013 remains the same throughout the term of the debt.

(a) **Governmental Activities**

Bonds and notes payable of governmental activities as of June 30, 2013, consist of the following:

Description and maturity date	Interest rate	Amount outstanding
Note payable AHMSP Act No. 124 due on August 1, 2016 and each August 1, thereafter to August 1, 2031	3.10%–6.50%	\$ 3,430,564

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Note Payable to Puerto Rico Public Finance Corporation – On December 27, 2001, the Housing Finance Authority entered into a loan agreement (the Note) with the GDB Operating Fund to refinance the AHMSP Act No. 124 note payable of the Housing Finance Authority, as authorized by Act No. 164 of December 17, 2001. PFC acquired and restructured the Note through the issuance of its Commonwealth appropriations bonds (the PFC Bonds). The PFC Bonds were issued under certain trust indentures whereby the Public Finance Corporation pledged the Note, along with other notes under Act No. 164, to certain trustees and created a first lien on the revenues of the notes sold (consisting of Commonwealth appropriations earmarked to repay these notes) for the benefit of the bondholders.

During June 2004, the Public Finance Corporation advance refunded a portion of certain of its outstanding Commonwealth appropriation bonds issued in 2001 under Act No. 164 of December 17, 2001. The Housing Finance Authority recognized a mirror effect of this advance refunding by the Public Finance Corporation on its own notes payable in proportion to the portion of the Housing Finance Authority's note payable included in the Public Finance Corporation refunding. The aggregate debt service requirements of the refunding and unrefunded notes will be funded with annual appropriations from the Commonwealth.

The outstanding balance of this note at June 30, 2013, was \$3,500,735 and matures on August 1, 2031. Interest on the unpaid principal amount of the Note is equal to the applicable percentage of the aggregate interest payable on the PFC Bonds. The applicable percentage is the percentage representing the proportion of the amount paid by PFC on the PFC Bonds serviced by the Note to the aggregate amount paid by PFC on all the PFC Bonds issued by PFC under Act No. 164.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(b) Business-Type Activities

Bonds, notes and mortgage-backed certificates payable of business-type activities consist of the following:

<u>Description and maturity date</u>	<u>Interest rate</u>	<u>Carrying amount</u>
Remarketed Refunding Bonds – December 1, 2015	4.75%	\$ 267,000,000
GDB Senior Notes :		
Series 2006 B – Each December 1 until December 1, 2017	5.00	237,691,768
Series 2006 C – January 1, 2015	5.25	82,583,081
Series 2010 A – August 1, 2020	5.50	433,702,000
Series 2010 B – August 1, 2025	5.75	151,259,000
Series 2010 C – August 1, 2019	5.40	217,715,000
Series 2010 D – August 1, 2025	5.75	96,411,000
Series 2011 A – April 1, 2014	3.90	70,000,000
Series 2011 B – May 1, 2014 and May 1, 2016	3.67–4.704	650,000,000
Series 2011 H – August 1, 2015, August 1, 2017, August 1, 2019, Each August 1, from 2021 to 2023, and August 1, 2026	3.80–5.20	1,399,045,000
Senior 2011 I – August 1, 2014 and August 1, 2018	3.375–4.35	394,096,704
Senior 2012 A – February 1, 2015, February 1, 2017 and February 1, 2019	3.448–4.375	996,162,418
Mortgage Trust III:		
Each July 1 and January 1 until July 1, 2013	Zero Coupon	13,040,000
Each July 1 and January 1 until January 1, 2021	Zero Coupon	104,647,679
Single Family Mortgage Revenue Bonds – Portfolio XI – each December 1 and June 1 until December 1, 2039	3.460%–5.45%	16,600,000
Mortgage-Backed Certificates, 2006 Series A – Principal and interest payable monthly from September 29, 2006 to August 29, 2030	2.955%–6.560%	83,515,523
Special Obligation Notes, 2010 Series A and B – Principal and interest payable monthly from July 1, 2019 to May 1, 2040	6.96%–6.974%	17,711,959
Special Obligation Notes, 2011 Series A – Principal and interest payable monthly from September 1, 2021 to September 1, 2041	7.000%	10,024,207
Special Obligation Notes, 2012 Series A – Principal and interest payable monthly from June 18, 2022 to September 1, 2041	7.000	15,980,885
Special Obligation Notes, 2012 Series A – Principal and interest payable monthly from August 15, 2012 to August 15, 2032	5.875	29,776,955
Total		<u>\$ 5,286,963,179</u>

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(c) ***Mortgage Trust III***

On July 2011, the Housing Finance Authority restructured the outstanding bonds of the Mortgage Trust III with a carrying amount of approximately \$425 million. The restructuring took place as follows: 1) tender offer amounting to approximately \$144 million (including expenses related to the transaction) to acquire and cancel bonds with a carrying amount of approximately \$112 million, and 2) purchase AAA securities amounting to approximately \$160 million to establish an escrow account for the payment through maturity of bonds with a carrying amount of approximately \$129 million. As a result of the transaction, the Housing Finance Authority recognized a loss on early extinguishment of debt, of approximately \$28.8 million. In connection with this transaction the Housing Finance Authority also redeemed at carrying value approximately \$163 million in bonds held by the Bank. The restructuring released \$60 million in excess collateral which were transferred by the trustee of the Housing Finance Authority.

(d) ***Special Obligation Notes, 2012 Series A***

During the year ended June 30, 2013, the Housing Finance Authority issued \$30.5 million of Special Obligation Notes. These notes are collateralized by certain second mortgages originated under the Home Purchase Stimulus Program. These notes will be repaid from collections of principal and interest of the underlying collateral, net of servicing and guarantee fees. The second mortgage loans are guaranteed by the Authority's mortgage insurance fund created by Act No. 87. See note 14.

(e) ***Homeownership Mortgage Revenue Bonds***

On April 24, 2013, the Housing Finance Authority repaid bonds with a book value of approximately \$99.3 million through the sale of investments that were held as collateral for such bonds. The Housing Finance Authority recorded a loss on early extinguishment of bonds payable of approximately \$1.1 million in the accompanying statement of activities. In this transaction, the Housing Finance Authority was able to release approximately \$16.3 million in excess collateral.

(f) ***Special Obligation Notes, 2012 Series A***

On July 24, 2012, the Housing Finance Authority issued general obligation bonds, amounting to \$38 million secured by mortgage-backed securities amounting to \$34 million. The principal of and interest on the bonds will be payable by the Authority regardless of the performance of the mortgage loan collateral. The notes will carry a 5.875% annual interest rate paid monthly. The notes are subject to a redemption schedule that ranges from 100% to 103% on or after the second throughout the fifth anniversary of the date of issuance.

(g) ***Participation Agreement Payable***

On April 10, 2006, the Tourism Development Fund entered into a debt restructuring agreement with Hotel Dorado, S.E. (the Hotel) whereby the Tourism Development Fund, as guarantor of the Hotel's outstanding bonds, accelerated the payment of the bonds in exchange for a note receivable of \$26 million (the Note) from the Hotel. In addition, on April 10, 2006, the Tourism Development Fund entered into a participation agreement with a financial institution whereby the Tourism Development Fund transferred a 100% participation (the Participation) in the Note.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The Participation is subject to recourse and the Tourism Development Fund is obligated to purchase the loan from the financial institution upon the occurrence and during the continuance of an event of default under the participation agreement. The participation agreement also stipulates that the financial institution cannot sell, pledge, transfer, assign or dispose of the Participation without the Tourism Development Fund's consent. Accordingly, the Tourism Development Fund has recorded the Note as part of loans receivable and has recorded a participation agreement payable (i.e. a collateralized borrowing) in the accompanying statement of net position and balance sheet – proprietary funds.

The Participation bears a variable interest rate based on the three month LIBOR plus 2.7826%, until maturity on July 1, 2018. The outstanding principal balance of the Note and the corresponding participation agreement payable amounted to \$24.3 million as of June 30, 2013.

The activity for noncurrent accounts payable and accrued liabilities during the year ended June 30, 2013, follows:

Balance – beginning of period	\$	15,194,343
Additions		<u>3,415,377</u>
Balance – end of period	\$	<u><u>18,609,720</u></u>

The activity for compensated absences included within accounts payable and accrued liabilities during the year ended June 30, 2013, follows:

		<u>Beginning balance</u>	<u>Provision</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Vacation	\$	2,671,195	2,839,263	3,135,405	2,375,053	1,945,268
Sickness		<u>2,447,604</u>	<u>1,672,201</u>	<u>1,803,465</u>	<u>2,316,340</u>	<u>443,748</u>
Total	\$	<u><u>5,118,799</u></u>	<u><u>4,511,464</u></u>	<u><u>4,938,870</u></u>	<u><u>4,691,393</u></u>	<u><u>2,389,016</u></u>

Compensated absences are available to be liquidated by the employees during the year. Amounts due within one year are estimated based on history of reductions.

(14) Mortgage Loan Insurance Fund

The Mortgage Loan Insurance fund was created by Act No. 87 of June 25, 1965, as amended, known as the Mortgage Loan Insurance. This act provides mortgage credit insurance to low and moderate-income families on loans originated by the Housing Finance Authority and other financial institutions. This activity can be increased through legislative appropriations, if and when needed, and derives its revenue from premiums charged to the borrowers, interest on investments, and sales of properties acquired through foreclosure. The Housing Finance Authority manages the risk of loss of its mortgage loan insurance activities by providing its insurance program only to financial institutions that (1) maintain certain defined minimum capital, (2) are qualified based on experience and resources, (3) perform certain collection efforts, and (4) comply with established procedures and requirements. In addition, the Housing Finance

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Authority requires certain loan-to-value ratios on loans insured and recording of the collateral in the property registry of the Commonwealth.

Additionally, the Housing Finance Authority created the Puerto Rico Housing Administration program, known in Spanish as “FHA Boricua”, expanding requirements and parameters under the existing act. The program allows citizens, paying an annual insurance premium, to originate mortgage loans with up to a 98% loan-to-value ratio. The program insures participating lending institutions in events of foreclosure. The program is financed through annual insurance premiums, commitment and transaction fees, and proceeds from any sale of foreclosed real estate. The program also requires participants to comply with various eligibility requirements.

The Commonwealth guarantees up to \$75 million of the principal insured by the mortgage loan insurance program. As of June 30, 2013, the mortgage loan insurance program covered loans aggregating to approximately \$508 million.

The mortgage insurance loan total premium and investment income for the years ended June 30, 2013, are as follows:

Mortgage loan insurance premiums	\$	4,932,860
Investment income		624,227
Total	\$	<u><u>5,557,087</u></u>

The regulations adopted by the Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the Mortgage Loan Insurance Fund. At June 30, 2013, the Housing Finance Authority had restricted net position for such purposes of approximately \$64.9 million.

The summary of the activity in the allowance for losses on mortgage loan insurance for the year ended June 30, 2013, is as follows:

Balance – beginning of year	\$	4,299,046
Provision for losses on mortgage loan insurance		885,481
Claims paid		(2,001,793)
Recoveries		2,001,793
Balance – end of year	\$	<u><u>5,184,527</u></u>

(15) Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Bank is party to transactions involving financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. These instruments involve, to varying degrees, elements of credit risk in excess of amounts recognized in the accompanying

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

statement of net position and fund balance sheet. These off-balance-sheet risks are managed and monitored in manners similar to those used for on-balance-sheet risks. The Bank's exposures to credit loss for lending commitments, financial guarantees, and letters of credit are represented by the contractual amount of those transactions.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank, as applicable, evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include property, plant, and equipment, and income-producing commercial properties. Standby letters of credit and financial guarantees are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

At June 30, 2013, the off-balance-sheet risks consisted of the following (in thousands):

Financial instruments whose credit risk is represented by contractual amounts:

Financial guarantees – Private sector	\$	596,537
Standby letters of credit – Public sector		1,328,927
Commitments to extend credit – Public sector		1,358,305
Commitments to extend credit – Private sector		94,856

Following is the activity of the allowance for losses on guarantees and letters of credit for the year ended June 30, 2013:

	<u>Beginning balance</u>	<u>Provision</u>	<u>Payments/ reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Tourism Development Fund	\$ 91,931,326	155,913,928	—	247,845,254	23,940,462
Development Fund	1,030,000	13,628,225	365,518	14,292,707	4,692,825
Total	<u>\$ 92,961,326</u>	<u>169,542,153</u>	<u>365,518</u>	<u>262,137,961</u>	<u>28,633,287</u>

On September 22, 2011, Autopistas Metropolitanas de Puerto Rico, LLC (Metropistas) and HTA, a component unit of the Commonwealth, entered into a concession agreement (the Concession Agreement) of toll roads PR-22 and PR-5 (the Toll Roads). In connection with this transaction, the HTA received in exchange for the right to operate the Toll Roads a lump-sum payment of \$1.1 billion and a commitment to make immediate improvements to the Toll Roads amounting to \$56 million and to comply with world-class operating standards which may require to invest to more than \$600 million over the life of the concession.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

In connection with the closing of the concession of the Toll Roads, the Bank executed a payment guarantee (the Guaranty) in favor of Metropistas pursuant to which it acts as guarantor of any "Termination Damages" due and payable in cash by the HTA under the Concession Agreement. For purposes of the Concession Agreement, "Termination Damages" refers to a payment that would arise if Metropistas elects to terminate the Concession Agreement as a result of: (i) an action that appropriates or sequesters all or a material part of the Toll Roads, the revenues derived there from and Metropistas' interest therein (or any of them) or materially impedes, substantially frustrates or renders impossible Metropistas' ability to perform its obligations for 90 consecutive days; and (ii) a material default by the HTA that is not remedied within the allowed grace periods. In both cases, the amount of Termination Damages would consist of: (a) the fair market value of Metropistas interest in the Toll Roads, plus (b) any compensation payable under the terms of the Concession Agreement for the period between the date of the occurrence of the event that gives rise to the Termination Damages and the termination date, such as loss of revenues and other documented losses; plus (c) out-of-pocket costs and expenses incurred by Metropistas as a result of the termination; less (d) insurance proceeds paid or payable to Metropistas (or which would have been payable to Metropistas but for a breach by Metropistas of the insurance policy or a requirement under the Concession Agreement to maintain insurance or the insolvency of the insurer). Termination Damages covered under the Guaranty also include the HTA's obligation to pay Metropistas the lesser of the fair market value of the concession or the unamortized concession fee if (i) the Concession Agreement is rescinded or terminated as a result of a conviction or guilty plea by Metropistas, its subsidiaries or its executives of a crime referred to in Act No. 458 of December 29, 2000, as amended to the extent such crime was not committed in connection with the procurement of the Concession Agreement, or (ii) Metropistas is convicted with respect to a crime under Act No. 237 of August 31, 2004, as amended, or Act No. 84 of June 18, 2002, as amended.

In connection with the Guaranty, on September 22, 2011, the Bank and the HTA entered into a Reimbursement Agreement (the Reimbursement Agreement) whereby the HTA agreed to reimburse the Bank any amounts paid under the Guaranty. Under the Reimbursement Agreement, in order to reimburse the Bank fully for any payments made under the Guaranty, the HTA is required to issue bonds secured by the revenues generated by the Toll Roads within one year from the effective date of a termination of the Concession Agreement requiring the payment of Termination Damages. On September 22, 2011, the HTA approved the bond resolution under which such bond issue would be authorized. Pending such bond issues, the reimbursement obligation will be secured by the revenues of the Toll Roads generated after the termination of the Concession.

On January 19, 2012, the Boards of Directors of the Bank and the Development Fund approved a loan guarantee program (the Guarantee Program) to stimulate lending by private banks to businesses in Puerto Rico in order to promote job creation and economic development in Puerto Rico. On April 3, 2012, the Bank, the Development Fund and certain participating banks entered into guarantee and commitment and funding agreements in which the Development Fund will guarantee eligible loans made by those banks to eligible businesses up to a maximum of 30% of the principal amount of the loans, in accordance with criteria established in the Guarantee Program. The Bank has committed to provide up to \$200 million to the Development Fund to enable it to honor payments related to guarantees issued under the Guarantee Program. The Guarantee Program had a term of one year, and it ended on April 2, 2013. As of June 30, 2013, total guarantees amounted to approximately \$56 million. The guarantee issued for each loan is in effect for a maximum term of seven years.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

On July 24, 2013, Aerostar Airport Holdings, LLC (Aerostar) and the Puerto Rico Ports Authority (the Ports Authority) entered into a lease agreement (the Lease Agreement) of Luis Muñiz Marín International Airport (the Airport), for a term of forty years. In connection with the lease of the Airport, the Bank executed a payment guarantee (the Bank Guaranty) in favor of Aerostar for any “Termination Damages” due and payable in cash by the Ports Authority under the Lease Agreement. In accordance with the Bank Guarantee, Aerostar has the right to terminate the Lease Agreement mainly under three different noncompliance scenarios on the part of the Ports Authority.

First, if Aerostar has the right to terminate this Agreement in connection with an “Adverse Action” or “AA”, as defined in the Lease Agreement, and Aerostar has exercised such right, the Lease Agreement, subject to certain conditions specified in the Lease Agreement, shall terminate 120 days following the date of receipt of the AA-Notice by the Ports Authority, and on the “Reversion Date” the Ports Authority shall pay an amount (which amount shall be paid from general Ports Authority’s funds and not from Airport revenues) equal to the aggregate, without duplication, of (i) the Airport “Facility Leasehold Value”, as defined, as of the date of termination (which shall be determined as if no Adverse Action has occurred), plus (ii) the reasonable out-of-pocket and documented costs and expenses incurred by Aerostar as a direct result of such termination, plus (iii) the “Leasehold Compensation” calculated for the period between the date of the Adverse Action and the Reversion Date, less (iv) any insurance or condemnation proceeds payable to Aerostar (or that should have been payable to Aerostar but for (x) the insurer’s inability to pay, (y) the breach by Aerostar of an obligation to take out or maintain insurance under the Lease Agreement or (z) the invalidity or breach of any insurance policy caused by Aerostar under which such policy proceeds would have been paid) with respect to all or any portion of the Airport as a result of the occurrence of such Adverse Action (collectively, the AA-Termination Damages) to the Aerostar on the Reversion Date or, if the AA-Termination Damages are determined on a date subsequent to the Reversion Date, then not later than 60 days following the date of determination of the AA Termination Damages, including interest; provided that, subject to the right of Aerostar to receive interest from the Reversion Date to the date on which payment is made, the Ports Authority may defer any such payment for an additional 120 days if it reasonably determines that such additional period is necessary to obtain financing or required approvals to make such a payment, as specified in the Lease Agreement.

Secondly, if termination relates to a default (a Default) on the part of the Ports Authority, that is, in accordance with Section 16.2 (b) (ii) or Section 16.2 (b) (iii) of the Lease Agreement, the Ports Authority shall be obligated to pay on the Reversion Date to Aerostar an amount (which amount shall be paid from general Ports Authority’s funds and not from Airport revenues) equal to the aggregate, without duplication, of (i) the Airport “Facility Leasehold Value” as of the date of termination, plus (ii) the reasonable out-of-pocket and documented costs and expenses incurred by Aerostar as a direct result of such termination, plus (iii) the “Leasehold Compensation” calculated for the period between the date of the Ports Authority’s Default and the date of termination, less (iv) any insurance or condemnation proceeds payable to Aerostar (or that should have been payable to Aerostar but for (x) the insurer’s inability to pay, (Y) the breach by Aerostar of an obligation to take out or maintain insurance under the Lease Agreement or (2) the invalidity or breach of any insurance policy caused by Aerostar under which such policy proceeds would have been paid) with respect to all or any portion of the Airport as a result of the occurrence of such Ports Authority’s Default (collectively, the AD-Termination Damages) to Aerostar or, if the AD Termination Damages are determined on a date subsequent to the Reversion Date, then not later

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

than 60 days following the date of determination of the AD-Termination Damages, including interest; provided that, subject to the right of Aerostar to receive interest from the Reversion Date to the date on which payment is made, the Ports Authority may defer any such payment for an additional 120 days if the Ports Authority reasonably determines that such additional period is necessary to obtain financing or required approvals to make such a payment, as specified in the Lease Agreement.

Thirdly, and as general provision, the Lease Agreement may be rescinded in accordance with Section 16.6 of the Lease Agreement which relates to termination pursuant to conviction or the entering of a plea of guilty in respect to any Act No. 458 Crime. If the Lease Agreement is rescinded or terminated pursuant to Section 16.6 (a) or (b) and, in the case of a rescission caused by the conviction or the entering of a plea of guilty for an Act No. 458 Crime, such crime was not committed in connection with the procurement of the Lease Agreement, then the Ports Authority shall be obligated to pay to Aerostar an amount equal to the lesser of (i) the Airport "Facility Leasehold Value" and (ii) the "Unamortized Leasehold Fee", in each case calculated as of the "End Date", all terms as defined, (the PIC-Termination Damages); provided that, (x) subject to the right of Aerostar to receive interest from the End Date to the date on which payment is made, the Ports Authority may defer any such payment for an additional 120 days if the Ports Authority reasonably determines that such additional period is necessary to obtain financing or required approvals to make such payment, as specified in the Lease Agreement.

(16) Retirement System

(a) *Defined Benefit Pension Plan*

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the Retirement System), created pursuant to Act No. 447 of May 15, 1951, as amended, is a cost-sharing, multiple-employer, defined benefit pension plan sponsored by and reported as a component unit of the Commonwealth. All regular employees of the Bank hired before January 1, 2000 and less than 55 years of age at the date of employment became members of the Retirement System as a condition of their employment. No benefits are payable if the participant receives a refund of their accumulated contributions.

The Retirement System provides retirement, death, and disability benefits pursuant to legislation enacted by the Legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after 10 years of plan participation. Disability benefits are available to members for occupational and nonoccupational disabilities. However, a member must have at least 10 years of service to receive nonoccupational disability benefits.

Members who have attained 55 years of age and have completed at least 25 years of creditable service, or members who have attained 58 years of age and have completed 10 years of creditable service, are entitled to an annual benefit payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Participants who have completed 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65% of the average compensation, as defined; otherwise, they will receive 75% of the average compensation, as defined.

Commonwealth's legislation requires employees to contribute 5.775% of the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Bank is required to contribute 10.275% of each participant's gross salary. On April 4, 2013, the Legislature enacted Act. No. 3 which amended Act No. 447 to establish a new retirement program.

(b) *Defined Contribution Plan*

The Legislature enacted Act No. 305 on September 24, 1999, which amended Act No. 447 to establish, among other things, a defined contribution savings plan program (the Program) to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000, and former employees who participated in the defined benefit pension plan, received a refund of their contributions, and were rehired on or after January 1, 2000, become members of the Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the defined benefit pension plan had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interest thereon to the Program.

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to individual accounts established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant's account semiannually.

The Bank is required to contribute 10.275% of each participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan. On April 4, 2013, the Legislature enacted Act. No. 3 which amended Act No. 305 to establish a new retirement program.

Upon retirement, the balance in each participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant's spouse in case of the participant's death. Participants with a balance of \$10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in each participant's account will be paid in a lump sum to the participant's beneficiaries. Participants have the option of receiving a lump sum or purchasing an annuity contract in case of permanent disability.

(c) *Defined Contribution Hybrid Program*

On April 4, 2013, the Legislature enacted Act. No. 3 which amended Act No. 447 and Act. No. 305 to establish, among other things, a defined contribution hybrid program (the Hybrid Program) to be administered by the Retirement System. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit pension plan and the defined contribution plan, and were rehired on or after July 1, 2013, become members of the Hybrid

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous plans will become part of the Defined Contribution Hybrid Program.

Participants in the defined benefit pension plan who as of June 3, 2013, were entitled to retire and receive some type of pension, may retire on any later date and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program. Participants who as of June 30, 2013, have not reached the age of 58 and completed 10 years of service or have not reached the age of 55 and completed 25 years of service can retire depending on the new age limits defined by the Hybrid Program and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program.

Participants in the defined contribution plan who as of June 30, 2013, were entitled to retire because they were 60 years of age may retire on any later date and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program. Participants in the Program who as of June 30, 2013, have not reach the age of 60 can retire depending on the new age limits defined by the Hybrid Program and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program.

Act. No. 3 requires employees to contribute ten percent (10%) of their monthly gross salary to the Hybrid Program. Employee contributions are credited to individual accounts established under the Hybrid Program. In addition a mandatory contribution equal to or less than point twenty five percent (0.25%) is required for the purchase of disability insurance.

The Bank is required to contribute 12.275% of each participant's gross salary. The Retirement System will use these contributions to increase its level of assets and to reduce the actuarial deficit. Beginning on July 1, 2013, and up until June 30, 2016, the employer's contribution rate shall be annually increased by one percent (1%). Beginning July 1, 2016, and up until June 30, 2021, the employer's contribution rate that is in effect on June 30 of every year shall be annually increased on every successive July 1st by one point twenty-five percent (1.25%).

Upon retirement, the balance in each participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life. In case of the pensioner's death the designated beneficiaries will continue receiving the monthly benefit until the contributions of the participant are completely consumed. In case of the participants in active service a death benefit will be paid in one lump sum in cash to the participant's beneficiaries. Participants with a balance of less than \$10,000 or less than five years of computed services at retirement will receive a lump-sum payment. In case of permanent disability the participants have the option of receiving a lump sum or purchasing an annuity contract.

Total employee contributions for the defined benefit pension plan and the defined contribution plan during the year ended June 30, 2013, amounted to approximately \$615,000 and \$966,000, respectively. The Bank's contributions during the years ended June 30, 2013, 2012 and 2011 amounted to approximately \$2,142,000, \$1,830,000, and \$1,731,000, respectively. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the Retirement System itself.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Employee and Bank's contributions to the defined contribution hybrid program will commence on fiscal year 2014.

Additional information on the Retirement System is provided on its standalone financial statements for the year ended June 30, 2012, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico, P.O. Box 42004, San Juan PR 00940-2004.

(17) Early Retirement Programs

From time to time the Bank extends to its employee's voluntary early retirement programs. During the year ended June 30, 2013, a program was approved by the Bank's Board of Directors and provided two election periods that ended on October 30, 2012 and December 14, 2012 based on provisions established on Act No. 70, which was enacted July 2, 2010. Act No. 70 provides that eligible employees may retire from employment with the Commonwealth in exchange for an early pension, an economic incentive and other benefits. Act No. 70 only applied to employees who were fifteen years or less from retirement in accordance with their applicable retirement plans. The extensions of Act No. 70 approved by the Bank's Board of Directors provides the following:

- The employee will receive an annuity based on the years of service credited by the Retirement System. Employees with fifteen years of service will receive 37.5% of the salary in effect at the election period. The percent will increase 2.5% each year until nineteen years of service. Employees with years of service between twenty and twenty nine will receive an annuity of 50%.
- The Bank is responsible for the payment of the annuity in addition to the related employee and employer contributions to the Retirement System until each employee is eligible for retirement based on the normal requirements of the defined benefit pension plan or the defined contribution pension plan.
- The employee will receive an economic incentive of six month's salary. This incentive is exempt from income taxes as established by Act No. 70.
- The employee will receive the benefits of health and dental insurance for a period of one year.

The number of employees who have voluntarily separated from employment under the provisions of Act No. 70 were three during the year ended June 30, 2013. Payments of such voluntary termination plans are expected to be made until June 30, 2020. Employee and employer contributions to the Retirement System and the employee annuity for the applicable period were discounted based on the average interest rate of return of unpledged investments.

During the fiscal years 1995, 2000 and 2007, the Bank's Board of Directors authorized early retirement's programs for certain Bank's employees, subject to different eligibility provisions that are detailed in the corresponding laws signed by the Governor of the Commonwealth. The costs incurred and accounted during the year ended June 30, 2013, consisted principally of the incremental actuarial costs, if any, of retiring earlier than under the original retirement plan to cover the costs of the medical and life insurance plans for such employees until reaching certain age. As of June 30, 2013, the number of employees still benefiting from such voluntarily separation programs are approximately 210. Employer contributions to

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

the medical and life insurance plans for the applicable period were discounted based on management best estimate of the expected long-term plan performance.

During fiscal year 2013, total cost related to these early termination benefits amounted to approximately \$4.3 million. As of June 30, 2013, the total liability related to these termination benefits was approximately \$18.5 million. Payments of such voluntary termination plans are expected to be made until June 30, 2021.

The Bank's contributions to the early retirement programs during the years ended June 30, 2013, amounted to approximately \$2,620,000. These amounts represented 100% of the required contribution for the corresponding year.

(18) Risk Management

To minimize the risk of loss, the Bank purchases insurance coverage for public liability, hazard, automobile, crime, and bonding as well as workmen's insurance for employees. The selection of the insurer has to be approved by the Public Insurance Office of the Department of the Treasury of the Commonwealth. Insurance coverage is updated annually to account for changes in operating risk. For the last three years, insurance settlements have not exceeded the amount of coverage.

(19) Commitments and Contingencies

(a) Lease Commitments

The Bank leases office and storage space from the governmental and private sectors. Principally, office space is leased under a short-term operating lease agreement that renews automatically every year, if it is not canceled by any of the parties before the beginning of each year. The storage space agreement expires in July 2016. During fiscal year 2010, the Bank entered into a lease agreement with the Puerto Rico Industrial Development Company (PRIDCO) for office space in PRIDCO's New York Office. This agreement expires in 2022.

The Housing Finance Authority entered into a 30-year lease agreement with the DOH to rent office space expiring in 2037. During the term of the lease, the Housing Finance Authority will pay an annual rent of \$1.5 million. The agreed upon rent includes parking spaces, maintenance and security services in common areas. DOH will be responsible for the payment of utilities in exchange for an additional payment of \$350,000 payable in a lump sum on or before August 31st of each year.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

Rent charged to operations in fiscal year 2013 amounted to approximately \$2.8 million. At June 30, 2013, the minimum annual future rentals under noncancelable leases are approximately as follows:

	Amount
Year ending June 30:	
2014	\$ 2,874,000
2015	2,881,000
2016	2,889,000
2017	2,590,000
2018	2,594,000
Thereafter	47,783,000
Total	\$ 61,611,000

(b) Cooperative Development Investment Fund

On August 18, 2002, the Legislature approved Act No. 198, which creates the Cooperative Development Investment Fund. The purpose of this fund is to promote the development of cooperative entities. This fund will be capitalized through contributions to be provided by the Bank up to \$25 million to be matched by cooperative entities. As of June 30, 2013, the Bank has contributed \$19.3 million, including interests to the Cooperative Development Investment Fund, \$1.4 million of which were contributed during the year ended June 30, 2013.

(c) Other Risks Related to Mortgage Loans Servicing and Insurance Activities

Certain loan portfolios of the Housing Finance Authority are administered by private servicers who are required to maintain an error and omissions insurance policy. The Housing Finance Authority has a program to manage the risk of loss on its mortgage loan lending and insurance activities.

(d) Loan Guarantees

The Development Fund has entered into an agreement (the Agreement) with Economic Development Bank for Puerto Rico (EDB) whereby the Development Fund would guarantee a portion of loans granted by EDB under a government program named The Key for Your Business (the Program). Under the Agreement, the Development Fund would assign \$15 million of its capital for the program. The Development Fund guarantees one-third of the outstanding principal balance of each loan plus accrued interest and certain other charges. The Development Fund charges one percent of the loan amount as guarantee fee and no loan can exceed \$50,000.

In addition the Bank, the Development Fund, and certain participating banks enter into guarantee and commitment and funding agreements (the Guarantee Program) in which the Development Fund guarantees eligible loans made by such banks to eligible businesses up to a maximum of 30% of the principal amount of the loans. The Guarantee Program started on April 3, 2012 and ended on April 3, 2013. As of June 30, 2013 guarantees amounted to approximately \$56 million.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

At June 30, 2013, the outstanding balance of loans guaranteed by the Development Fund amounted to approximately \$6.6 million and the allowance for losses on guarantees amounted to approximately \$664,000 thousands.

(e) *Mortgage Loan Servicing Activities*

The Housing Finance Authority acts as servicer for a number of mortgage loans owned by other investors. The servicing is generally subcontracted to a third party. As of June 30, 2013, the principal balance of the mortgage loans serviced for others is approximately as follows:

Puerto Rico Community Development Fund I	\$ 42,750,000
R-G Mortgage, Inc. or its successor	1,315,586
CRUV or its successor without guaranteed mortgage loan payments	28,375
Total	\$ 44,093,961

(f) *HOME Program*

The U.S. Office of Inspector General (OIG) has performed various examinations of the HOME Program covering fiscal years ended prior to July 1, 2010. These examinations covered periods in which the HOME Program was under the administration of the Department of Housing. These examinations identified instances of noncompliance with terms and conditions of the grant agreements, applicable federal law, and the HOME Program's regulations, including but not limited to the expenditure of resources for ineligible purposes. OIG identified in its examinations disallowed costs amounting to approximately \$18.3 million. The Authority recorded a contingency for such disallowed costs amounting to approximately \$14.3 million. On May 2013, the Authority entered into a three year repayment plan, starting on August 1, 2013, with HUD to return HOME funds amounting to approximately \$1.8 million that were determined to be disallowed costs within the \$18.3 million discussed above. The Authority also recorded a contingency amounting to approximately \$6.1 million for additional amounts identified internally that could be deemed as disallowed costs by HUD.

(g) *Litigation*

The Bank and certain of its component units are defendants in several lawsuits arising out of the normal course of business. Management, based on advice of legal counsel, is of the opinion that the ultimate liability, if any, resulting from these pending proceedings will not have a material adverse effect on the financial position and results of operations of the Bank or its component units.

(20) *Conduit Debt and Programs Sponsored by the Housing Finance Authority*

The Public Finance Corporation has issued approximately \$8.1 billion of Commonwealth appropriation bonds (the Bonds) maturing at various dates through 2033. The proceeds of the Bonds, except for approximately \$4.6 billion, were used to provide the necessary funds to purchase from the Bank separate promissory notes of the Department of the Treasury of the Commonwealth and certain of its instrumentalities and public corporations (the Promissory Notes). The \$4.6 billion referred to above was used to refund a portion of certain bonds issued by the Public Finance Corporation between fiscal years

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

1995 and 2005. The outstanding balance of the Bonds at June 30, 2013 amounted to approximately \$1.1 billion.

The Bonds are limited obligations of the Public Finance Corporation and, except to the extent payable from bond proceeds and investment earnings thereon, will be payable solely from a pledge and assignment of amounts due under the Promissory Notes. Principal and interest on the Promissory Notes are payable solely from legislative appropriations to be made pursuant to acts approved by the Legislature of the Commonwealth. These acts provide that the Commonwealth shall honor the payment of principal and interest on the Promissory Notes, and that the Director of the OMB shall include in the budget of the Commonwealth submitted to the Legislature the amounts necessary to pay the principal and interest on the Promissory Notes. The Promissory Notes represent debt of the issuing instrumentalities (all part of the Commonwealth or its component units), and, for purposes of the Public Finance Corporation, the Bonds are considered conduit debt. Neither the Bonds nor the Notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements.

Certain bonds of the Housing Finance Authority are considered conduit debt as more fully described in Note 2. At June 30, 2013, there were restricted assets held in trust by others, outstanding obligations, fund balances, and excess of fund expenses over revenues, net of transfers (all of which are excluded from the accompanying basic financial statements), as indicated below (unaudited):

Restricted assets	\$	797,414
Restricted liabilities (conduit debt)		<u>(797,414)</u>
Restricted fund balance	\$	<u><u>—</u></u>

On December 2003, the Housing Finance Authority issued \$663 million in Capital Fund Program Bonds Series 2003 to lend the proceeds thereof to the Public Housing Administration (PHA), a governmental instrumentality of the Commonwealth. PHA utilized such funds for improvements to various public housing projects in the Commonwealth. The Capital Fund Program Bonds Series 2003 are limited obligations of the Housing Finance Authority, which will be paid solely from an annual allocation of public housing capital funds when received from the U.S. Department of Housing and Urban Development and other funds available under the bonds indenture. Accordingly, these bonds are considered conduit debt and are not presented in the accompanying basic financial statements. The outstanding balance of these bonds amounted to \$468,505,000 at June 30, 2013.

On August 1, 2008, the Housing Finance Authority issued the Capital Fund Modernization Program Subordinate Bonds amounting to \$384,475,000 and the Housing Revenue Bonds amounting to \$100,000,000. The proceeds from the issuance were mainly used to finance a loan to a limited liability company (the LLC) and pay the costs of issuance. The \$384,475,000 bonds are limited obligations of the Housing Finance Authority, payable primarily by a pledge and assignment of federal housing assistance payments made available by the U.S. Department of Housing and Urban Development, with an outstanding balance of \$319,900,000 at June 30, 2013. The \$100,000,000 bonds were also limited obligations of the Housing Finance Authority, payable from amounts deposited in escrow accounts with a trustee and the proceeds of a loan to be made by the Housing Finance Authority to the LLC using moneys received as a grant from DOH. Payment of principal of the Housing Revenue Bonds was also secured by an irrevocable

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

standby letter of credit issued by the Bank. The Housing Revenue Bonds were paid-off on September 30, 2011.

(21) Interfund Balances and Transfers

The following table is a summary of the interfund balances as of June 30, 2013, between governmental funds and proprietary funds:

<u>Receivable by</u>	<u>Payable by</u>	<u>Purpose</u>	<u>Amount</u>
Governmental fund:	Proprietary fund:		
Other nonmajor funds (New Secure Housing Program)	GDB Operating Fund	Demand deposits and accrued interest	\$ 298,547
HUD Programs	GDB Operating Fund	Demand deposits and accrued interest	57,678
AHMSP Act No. 124	GDB Operating Fund	Investment agreements and accrued interest	548,075
AHMSP Act No. 124	GDB Operating Fund	Demand deposits and accrued interest	399,801
AHMSP Act No. 124	GDB Operating Fund	Demand deposits and and accrued interest	53,481
AHMSP Act No. 124	GDB Operating Fund	Investment agreements and accrued interest	15,289,450
Other nonmajor funds (Closing Costs Assistance Program)	GDB Operating Fund	Demand deposits and accrued interest	467,201
My New Home Program	GDB Operating Fund	Demand deposits and accrued interest	620,574
My New Home Program	GDB Operating Fund	Certificates of deposit and accrued interest	1,306,447
AHSMP Act No. 124	GDB Operating Fund	Certificates of deposit and accrued interest	6,549,297
AHSMP Act No. 124	GDB Operating Fund	Demand deposits and accrued interest	60,171
Subtotal			<u>\$ 25,650,722</u>

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

<u>Receivable by</u>	<u>Payable by</u>	<u>Purpose</u>	<u>Amount</u>
Balance brought forward			\$ 25,650,722
Proprietary fund:	Governmental fund:		
GDB Operating Fund	Other nonmajor funds (New Secure Housing Program)	Loans payable and accrued interest	(51,362,914)
GDB Operating Fund	AHMSP Act No. 124	Loans payable and accrued interest	(39,278,886)
GDB Operating Fund	AHMSP Act No. 124	Loans payable and accrued interest	(13,347,727)
GDB Operating Fund	My New Home Program	Loans payable and accrued interest	(92,916,470)
Housing Finance Authority	Other nonmajor funds (New Secure Housing Program)	Reimbursement of expenditures	(2,707,589)
Housing Finance Authority	HUD Programs	Reimbursement of expenditures	(1,023,514)
Housing Finance Authority	My New Home Program	Reimbursement of expenditures	(20,750)
Housing Finance Authority	HOME Programs	Reimbursement of expenditures	(1,365,174)
Total			<u>(202,023,024)</u>
Total internal balances – net			<u>\$ (176,372,302)</u>

With the exception of investment agreements of \$15.8 million and loans payable of \$1.9 million, all of the remaining amounts due from internal balances or due to internal balances are due within one year.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

The summary of interfund balances as of June 30, 2013, among proprietary funds, is as follows:

<u>Receivable by</u>	<u>Payable by</u>	<u>Purpose</u>	<u>Amount</u>
Proprietary funds:	Proprietary funds:		
Housing Finance Authority	GDB Operating Fund	Demand deposits and accrued interest	\$ 2,042,219
Development Fund	GDB Operating Fund	Demand deposits and accrued interest	6,419,664
Tourism Development Fund	GDB Operating Fund	Demand deposits and accrued interest	21,712,510
Public Finance Corporation	GDB Operating Fund	Demand deposits and accrued interest	1,190,144
Other nonmajor (Education Assistance Corporation)	GDB Operating Fund	Demand deposits and accrued interest	2,386,191
Other nonmajor (JMB Institute)	GDB Operating Fund	Demand deposits and accrued interest	44,830
Housing Finance Authority	GDB Operating Fund	Certificates of deposit and accrued interest	151,400,988
GDB Operating Fund	Tourism Development Fund	Loans receivable and accrued interest	<u>339,100,799</u>
Total balance among proprietary funds eliminated			<u>\$ 524,297,345</u>

The following table is a summary of interfund transfers for the year ended June 30, 2013:

<u>Transfer out</u>	<u>Transfer in</u>	<u>Transfer for</u>	<u>Amount</u>
Governmental funds:	Governmental funds:		
AHMSP Act No. 124	My New Home Program	Release of excess funds	\$ 5,000,000
AHMSP Act No. 124	Other nonmajor funds (New Secure House Program)	Interest Line of Credit	885,252
Governmental funds:	Proprietary funds:		
AHMSP Act No. 124	Housing Finance Authority	Release of excess funds	15,923
Proprietary funds:	Governmental funds:		
Housing Finance Authority	AHMSP Act No. 124	Trustee fees payments	8,500
Housing Finance Authority	AHMSP Act No. 124	Subsidy payments	1,233,717
Proprietary funds:	Proprietary funds:		
GDB Operating Fund	Other nonmajor funds (JMB Institute)	Contribution	100,000
GDB Operating Fund	Tourism Development Fund	Contribution	28,781,250

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(22) Funds Deficit

The following governmental funds reflect a deficit at June 30, 2013: My New Home Program, HOME Program and New Secure Housing Program for the amount of \$91.4 million, \$6.8 million, and \$55.8 million, respectively. The deficit of the My New Home Program is due to the amounts borrowed by the Housing Finance Authority from the Bank that were used to provide housing subsidies. The deficit of the New Secure Housing Program is due to FEMA discontinued reimbursement of the Housing Finance Authority's allowable costs. The deficit of the Home Program is due to the deferral of revenue that was not considered available for current expenditures. Except for the Home Program, the Housing Finance Authority expects to cover these deficits through future contributions from the Commonwealth.

The deficit in the Tourism Development fund, a proprietary fund, is mostly due to the accrual of the allowance for loan losses and allowance for guarantees and letter of credits. The Tourism Development Fund expects to cover this deficit through future contributions from the Commonwealth as permitted by the legislation that created the Tourism Development Fund (See note 3(f)).

(23) Subsequent Events

Act No. 34 of June 26, 2013 was enacted to provide subsidies to eligible individuals of families for the purchase of an eligible principal residence. To that effect the Housing Finance Authority created, in July 2013, My Own Home Fund and transferred \$6.1 million of its own Funds for the operation of the program. The Housing Finance Authority is pending to receive \$9.2 million from OMB which will also be used on the program.