NEW ISSUE - BOOK-ENTRY ONLY
See "Book-Entry Only System" under *The Series B Notes*

In the opinion of Bond Counsel, under the provisions of the Acts of Congress now in force, (i) subject to continuing compliance with certain tax covenants, interest on the Series B Notes will not be includable in gross income for federal income tax purposes, and (ii) the Series B Notes and interest thereon will be exempt from state, Commonwealth and local taxation. Interest on the Series B Notes will not be treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations; however, the interest thereon will be included in the computation of the alternative minimum tax on corporations imposed by the Internal Revenue Code of 1986, as amended. See "Tax Exemption" herein.

$740,000,000
GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
Senior Notes, 2006 Series B

The Senior Notes, 2006 Series B (the "Series B Notes") will be issued as fully registered notes without coupons in denominations of $5,000 principal amount and integral multiples thereof and will initially be registered only in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York, which will act as securities depository for the Series B Notes. Purchasers of the Series B Notes will not receive physical delivery of such notes. Interest on the Series B Notes will accrue from the date of their issuance and will be payable semi-annually on each June 1 and December 1, commencing on December 1, 2006. The Series B Notes maturing after December 1, 2016 are subject to redemption prior to maturity as set forth herein, the earliest possible date of redemption being December 1, 2016.

The Series B Notes are being issued pursuant to the provisions of a trust indenture, dated as of February 17, 2006, as amended (the "Indenture"), between Government Development Bank for Puerto Rico ("Government Development Bank" or the "Bank") and Banco Popular de Puerto Rico. Under the Indenture, the Bank is authorized to issue additional notes on a parity with the Series B Notes and any notes previously issued under the Indenture. On February 17, 2006, the Bank issued under the Indenture $885,000,000 Senior Notes, 2006 Series A. Following the sale of the Series B Notes, Government Development Bank may issue under the Indenture and offer for sale to purchasers in the United States of America its Senior Notes, 2006 Series C (the "Series C Notes") in an aggregate principal amount of $70 million and offer for sale to purchasers in the Commonwealth of Puerto Rico its Senior Notes, 2006 Series D (the "Series D Notes") in an aggregate principal amount of approximately $300 million

The Series B Notes, the outstanding notes previously issued under the Indenture, and any additional notes that the Bank may from time to time issue under the Indenture (collectively, the "Notes") are general, unsecured, senior obligations of the Bank, ranking on a parity with all other general, unsecured and unsubordinated obligations of the Bank for borrowed money and with unsecured and unsubordinated Government Development Bank guarantees of obligations of others for borrowed money now or hereafter outstanding.

THE SERIES B NOTES DO NOT CONSTITUTE AN OBLIGATION OF THE COMMONWEALTH OF PUERTO RICO OR ANY OF ITS POLITICAL SUBDIVISIONS OR PUBLIC INSTRUMENTALITIES, OTHER THAN GOVERNMENT DEVELOPMENT BANK, AND NEITHER THE COMMONWEALTH OF PUERTO RICO NOR ANY OF ITS POLITICAL SUBDIVISIONS OR PUBLIC INSTRUMENTALITIES, OTHER THAN GOVERNMENT DEVELOPMENT BANK, IS LIABLE THEREON. NEITHER THE GOOD FAITH, CREDIT AND TAXING POWER OF THE COMMONWEALTH OF PUERTO RICO NOR THAT OF ANY OF ITS POLITICAL SUBDIVISIONS OR INSTRUMENTALITIES, OTHER THAN GOVERNMENT DEVELOPMENT BANK, IS PLEDGED FOR THE PAYMENT OF THE SERIES B NOTES.

The Series B Notes are offered for delivery when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Sidley Austin LLP, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by Pietrantoni Méndez & Alvarez LLP, San Juan, Puerto Rico. The Series B Notes are expected to be available for delivery through the facilities of The Depository Trust Company on or about May 25, 2006.

Goldman, Sachs & Co. | **Lehman Brothers**

Banc of America Securities LLC | **Citigroup**

JPMorgan | **Merrill Lynch & Co.**

Morgan Stanley | **Popular Securities**

Raymond James & Associates, Inc. | **Samuel A. Ramírez & Co.**

Wachovia Bank, National Association

May 17, 2006

$740,000,000
GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
Senior Notes, 2006 Series B

Maturity	Amount	Interest Rate	Yield
12/01/2006	$ 37,180,000	5.000%	3.932%
12/01/2007	6,840,000	4.125	4.160
12/01/2007	101,960,000	5.000	4.160
12/01/2008	92,915,000	5.000	4.200
12/01/2009	72,450,000	5.000	4.240
12/01/2010	63,295,000	5.000	4.260
12/01/2011	62,665,000	5.000	4.310
12/01/2012	66,205,000	5.000	4.390
12/01/2013	68,785,000	5.000	4.470
12/01/2014	68,810,000	5.000	4.570
12/01/2015	69,065,000	5.000	4.640
12/01/2016	19,195,000	5.000	4.680
12/01/2017	10,635,000	5.000	4.710

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

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE SERIES B NOTES AND GOVERNMENT DEVELOPMENT BANK'S OUTSTANDING NOTES AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

CERTAIN STATEMENTS CONTAINED IN THIS OFFICIAL STATEMENT REFLECT NOT HISTORICAL FACTS BUT FORECASTS AND "FORWARD-LOOKING STATEMENTS." THESE STATEMENTS ARE BASED UPON A NUMBER OF ASSUMPTIONS AND ESTIMATES THAT ARE SUBJECT TO SIGNIFICANT UNCERTAINTIES, MANY OF WHICH ARE BEYOND THE CONTROL OF GOVERNMENT DEVELOPMENT BANK. IN THIS RESPECT, THE WORDS "ESTIMATES," "PROJECTS," "ANTICIPATES," "EXPECTS," "INTENDS," "BELIEVES" AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. ALL PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINIONS, ESTIMATES AND OTHER FORWARD-LOOKING STATEMENTS ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT: ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY FORWARD-LOOKING STATEMENTS.

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SUMMARY

This summary highlights selected information contained elsewhere in this Official Statement. Because it is a summary, it does not contain all the information that a purchaser should consider before purchasing the Series B Notes offered hereby. A purchaser should read the entire Official Statement.

Government Development Bank

Government Development Bank for Puerto Rico ("Government Development Bank" or the "Bank") is a public corporation and governmental instrumentality of the Commonwealth of Puerto Rico (the "Commonwealth") created by law in 1948. Its principal functions are to act as fiscal agent and financial advisor to the Commonwealth and its instrumentalities, and to provide interim and, in some cases, long-term financing to the Commonwealth and its instrumentalities.

Since one of the Bank's principal functions is to provide financing to the Commonwealth and its instrumentalities, loans to such entities represent a significant portion of the Bank's assets. For that reason, this Official Statement includes or incorporates by reference operating and financial information about the Commonwealth and its instrumentalities and includes a discussion of recent developments relating to the Commonwealth's current fiscal situation.

As of December 31, 2005, the Bank had consolidated total assets of $10.4 billion, including $6.2 billion of loans receivable, mostly from the Commonwealth and its instrumentalities, and consolidated net assets of $2.1 billion. For the six month period ended December 31, 2005, the Bank's enterprise funds had consolidated operating revenues of $298.6 million and operating income of $83.8 million.

In October 2005, Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), lowered the Bank's long-term credit rating from BBB+ to BBB, with negative outlook, citing as the reasons therefor the alignment of the Bank's creditworthiness to that of the Commonwealth and the Commonwealth's current fiscal imbalance. On March 22, 2006, S&P placed the Commonwealth's and the Bank's rating on CreditWatch with negative implications. This recent action with respect to the Bank's rating was a result of the placement of the Commonwealth's rating on CreditWatch with negative implications. On May 16, 2006, Moody's Investors Service, Inc. ("Moody's") rated the Series B Notes "Baa3" and placed the ratings on Watchlist with negative implications. Further downgrades of the credit rating of the Commonwealth may result in further downgrades of the credit rating of Government Development Bank. For a discussion of recent rating action by S&P and Moody's affecting the Commonwealth and the Bank, see "Rating Action Involving the Commonwealth and Government Development Bank" under *Recent Developments Relating to the Commonwealth*.

Since loans to the Commonwealth represent a significant portion of the Bank's assets, the Commonwealth's fiscal situation and any further downgrade of the Commonwealth's credit rating may have an adverse impact on the Bank's financial condition. Any such further downgrade could also affect the Bank's liquidity and limit its access to the capital markets and other funding sources. Government Development Bank, however, believes that it has access to alternate funding sources. See "Possible Impact of the Commonwealth's Fiscal Imbalance on the Finances of Government Development Bank" and "Liquidity and Sources of Funding" under *Finances of Government Development Bank*.

Details of the Series B Notes

Offering	Government Development Bank for Puerto Rico Senior Notes, 2006 Series B (the "Series B Notes").
Issuer	Government Development Bank for Puerto Rico.
Principal Amount of the Series B Notes	$740,000,000
Use of Proceeds	The Bank will use the proceeds from the sale of the Series B Notes to provide a new source of funding for lines of credit provided to certain government agencies and public corporations in order to finance such borrowers' capital improvement programs.
Interest on the Notes	Interest on the Series B Notes is payable semi-annually on each June 1 and December 1, commencing on December 1, 2006.
Book-Entry Form	The Series B Notes will be issued in book-entry form through the book-entry system of The Depository Trust Company. Purchasers of the Series B Notes will not receive physical delivery of the notes.
Redemption	The Series B Notes maturing on or prior to December 1, 2016, are not subject to redemption prior to maturity. The Series B Notes maturing after December 1, 2016, are subject to redemption prior to maturity, either in whole or in part (and if in part, in such order of maturity as the Bank shall direct), at a price equal to the principal amount to be redeemed plus accrued interest to the date of redemption, as further described herein. The earliest possible date of redemption is December 1, 2016.
Note Program	The Series B Notes are being issued pursuant to the provisions of a trust indenture, dated as of February 17, 2006, as amended (the "Indenture"), between Government Development Bank and Banco Popular de Puerto Rico (the "Trustee") and a Resolution adopted by the Bank's Board of Directors (the "Resolution"). Under the Indenture, the Bank may issue additional notes on a parity with any notes issued under the Indenture. On February 17, 2006, the Bank issued its $885,000,000 Senior Notes, 2006 Series A. Following the sale of the Series B Notes, the Bank may issue and offer for sale to purchasers in the United States of America its Senior Notes, 2006 Series C (the "Series C Notes") in an aggregate principal amount of approximately $70 million and may issue and offer for sale to purchasers in the Commonwealth its Senior Notes, 2006 Series D (the "Series D Notes") in an aggregate principal amount of approximately $300 million.

Unsecured Notes	The Series B Notes, the outstanding notes previously issued under the Indenture, and any additional notes that the Bank may from time to time issue under the Indenture (collectively, the "Notes") are general, unsecured, senior obligations of the Bank, ranking on a parity with all other general, unsecured and unsubordinated obligations of the Bank for borrowed money and with unsecured and unsubordinated Government Development Bank guarantees of obligations of others for borrowed money now or hereafter outstanding. Neither the good faith, credit and taxing power of the Commonwealth nor that of any of its political subdivisions or instrumentalities, other than Government Development Bank, is pledged for the payment of the Notes.
Additional Debt Securities	Under the Indenture, the Bank may issue additional debt securities and may otherwise incur additional indebtedness without restriction.
Availability of Assets of Government Development Bank's Subsidiaries for Payment of the Notes	Because the Series B Notes are issued by Government Development Bank and are not guaranteed by the Bank's subsidiaries, holders of the Series B Notes will not have recourse against the Bank's subsidiaries. As of December 31, 2005, approximately \$2.2 billion out of Government Development Bank's consolidated total assets of \$10.4 billion were held by the Bank's subsidiaries and are, therefore, unavailable for payment of debt service on the Series B Notes.
Absence of Public Market	The Series B Notes are a new issue of securities. There is no assurance that a secondary market for the Series B Notes will develop, or if it does develop, that it will provide the holders of the Series B Notes with liquidity for their investment or that it will continue for the life of the Series B Notes. Although the Underwriters have advised the Bank that they presently intend to make a market for the Series B Notes as permitted by applicable laws, the Underwriters are not obligated to do so and any such market making may be discontinued at any time at the sole discretion of the Underwriters.
Governing Law	All rights and obligations under the Series B Notes will be governed by and construed in accordance with the laws of the Commonwealth of Puerto Rico.
Ratings	Moody's and S&P have rated the Series B Notes "Baa3" and "BBB," respectively. The ratings assigned by each of Moody's and S&P remain on Watchlist and CreditWatch, respectively, both with negative implications. For a discussion of recent rating action affecting Government Development Bank, see "Rating Action Involving the Commonwealth and Government Development Bank" under *Recent Developments Relating to the Commonwealth*.

Tax Exemption....................... In the opinion of Sidley Austin LLP, Bond Counsel, under the provisions of the Acts of Congress now in force, (i) subject to continuing compliance with certain tax covenants, interest on the Series B Notes will not be includable in gross income for federal income tax purposes and (ii) the Series B Notes and interest thereon will be exempt from state, Commonwealth and local taxation. Interest on the Series B Notes will not be treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations; however, the interest thereon will be included in the computation of the alternative minimum tax on corporations imposed by the Internal Revenue Code of 1986, as amended. See *Tax Exemption* for a description of these and other tax considerations.

FINANCIAL HIGHLIGHTS OF GOVERNMENT DEVELOPMENT BANK AND ITS SUBSIDIARIES

	As of and for the six month period ended December 31,		As of and for the year ended June 30,		
	2005	2004	2005	2004	2003
	(unaudited)		(in thousands)		
Financial Condition Trends Government Wide Total Amounts[1]					
Assets					
Federal Funds sold and securities purchased under agreements to resell	$ 1,185,500	$ 636,545	$ 1,651,000	$ 1,003,927	$ 1,233,400
Deposits placed with banks	263,449	60,445	354,703	313,752	413,028
Investments and investment contracts	2,395,218	2,205,729	2,316,169	3,276,355	4,230,252
Loans receivable, net	6,181,857	5,243,181	5,665,816	4,203,882	2,636,264
Total assets	10,417,747	8,485,911	10,366,126	9,222,714	8,866,974
Liabilities					
Deposits and commercial paper	5,979,175	4,452,424	6,063,863	3,812,894	3,536,558
Other borrowed funds	2,276,369	1,972,260	2,189,952	1,628,975	1,781,597
Total liabilities	8,359,102	6,526,473	8,403,963	6,906,577	6,711,195
Net assets	2,058,645	1,959,438	1,962,163	2,316,137	2,155,779
Income and Expense Trends Government Wide Total Amounts[1]					
Investment income – including changes in fair value of investments	106,798	86,922	171,062	155,152	258,403
Interest income on loans	174,632	117,613	251,050	216,034	132,891
Total investment income and interest income on loans	281,430	204,535	422,112	371,186	391,294
Total interest expense	195,492	108,511	257,767	190,065	212,936
Net investment income and interest income on loans	85,938	96,024	164,345	181,121	178,358
Provision for loan losses	-	-	3,812	2,424	1,275
Net interest income after provision for loan losses	85,938	96,024	160,533	178,697	177,083
Non-interest income	124,863	196,370	309,376	304,126	257,260
Non-interest expense	105,448	146,461	321,382	299,793	261,566
Contributions to others	8,871	502,632[3]	502,501[3]	22,672	19,185
Change in net assets	96,482	(356,699)[4]	(353,974)[4]	160,358	153,591
Profitability and Capitalization Ratios Enterprise Funds[2]					
Return on total average assets	1.13%	(9.39%)[5]	(3.55%)[5]	1.87%	2.05%
Change in net assets to average net assets	5.85%	(39.01%)[6]	(16.12%)[6]	7.56%	8.57%
Average net assets to average total assets	19.30%	24.08%	22.05%	24.72%	23.90%
Net assets to total assets	19.53%	22.70%	19.12%	25.11%	21.84%
Interest rate spread	0.98%	1.60%	1.13%	1.33%	1.07%
Net interest margin	1.75%	2.29%	1.77%	2.17%	1.99%

[1] Government wide total amounts combine the results of Government Development Bank's governmental activities and business-type activities. Governmental activities are generally financed through taxes, intergovernmental revenues, and other government appropriations. Business-type activities are financed in whole or in part by fees charged to third parties for goods or services. Housing Finance Authority, a subsidiary of Government Development Bank, accounts for all of Government Development Bank's governmental activities.

[2] The financial statements for the enterprise funds provide the same type of information as the business-type activities in the government wide financial statements, only in more detail.

[3] Includes a special contribution made by Government Development Bank of $500 million to the Special Communities Irrevocable Trust. See "Consolidated Schedule of Revenues, Expenses and Change in Net Assets – Enterprise Fund" and "Special Capital and Income Contributions by Government Development Bank" under *Finances of Government Development Bank.*

[4] Excluding the special contribution of $500 million made by Government Development Bank to the Special Communities Irrevocable Trust, the change in net assets for the six month period ended December 31, 2004 and for the year ended June 30, 2005 would have been $143 million and $146 million, respectively.

[5] Taking into account the special contribution of $500 million made by Government Development Bank to the Special Communities Irrevocable Trust. If the special contribution is excluded, the ratio for the six month period ended December 31, 2004 and for the year ended June 30, 2005 would have been 2.04% and 1.63%, respectively. See "Special Capital and Income Contributions by Government Development Bank" under *Finances of Government Development Bank.*

[6] Taking into account the special contribution of $500 million made by Government Development Bank to the Special Communities Irrevocable Trust. If the special contribution is excluded, the ratio for the six month period ended December 31, 2004 and for the year ended June 30, 2005 would have been 7.80% and 6.60%, respectively. See "Special Capital and Income Contributions by Government Development Bank" under *Finances of Government Development Bank.*

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GOVERNMENT DEVELOPMENT BANK
FOR PUERTO RICO

INTRODUCTORY STATEMENT

This Official Statement of Government Development Bank for Puerto Rico ("Government Development Bank" or the "Bank"), which includes the cover page, the inside cover page, the Table of Contents, the Summary, the Financial Highlights of Government Development Bank and its Subsidiaries and the appendices, is provided to furnish information with respect to its Senior Notes, 2006 Series B (the "Series B Notes"). The Bank is a public corporation and an instrumentality of the Commonwealth of Puerto Rico (the "Commonwealth").

The Series B Notes are being issued pursuant to the provisions of a trust indenture, dated as of February 17, 2006, as amended (the "Indenture"), between the Bank and Banco Popular de Puerto Rico (the "Trustee") and a Resolution adopted by the Board of Directors of Government Development Bank on May 17, 2006 (the "Resolution"). Under the provisions of the Indenture, the Bank may issue additional notes on a parity with any notes issued under the Indenture. On February 17, 2006, the Bank issued under the Indenture $885,000,000 Senior Notes, 2006 Series A. Following the sale of the Series B Notes, the Bank may issue under the Indenture and offer for sale to purchasers in the United States of America it Senior Notes, 2006 Series C (the "Series C Notes") in an aggregate principal amount of approximately $70 million and may issue under the Indenture and offer for sale to purchasers in the Commonwealth its Senior Notes, 2006 Series D (the "Series D Notes") in an aggregate principal amount of approximately $300 million.

The Series B Notes, the outstanding notes previously issued under the Indenture, and any additional notes that the Bank may from time to time issue under the Indenture (collectively, the "Notes") are general, unsecured, senior obligations of the Bank, ranking on a parity with all other general, unsecured and unsubordinated obligations of the Bank for borrowed money and with unsecured and unsubordinated Government Development Bank guarantees of obligations of others for borrowed money now or hereafter outstanding.

The Series B Notes are not a debt of the Commonwealth or any of its political subdivisions or instrumentalities, other than Government Development Bank, and neither the Commonwealth nor any of its political subdivisions or instrumentalities, other than Government Development Bank, is required to pay the Series B Notes.

Since one of the Bank's principal functions is to provide financing to the Commonwealth and its instrumentalities, loans to the Commonwealth and its instrumentalities represent a significant portion of the Bank's assets. Many of these loans are payable from legislative appropriations from the Commonwealth's General Fund. Accordingly, the payment of these loans may be affected by budgetary constraints of the Commonwealth. For more information on the impact of the Commonwealth's current fiscal situation on the Bank's finances, see "Possible Impact of the Commonwealth's Fiscal Imbalance on the Finances of Government Development Bank" under *Finances of Government Development Bank*. Government Development Bank may also be called upon to provide financial assistance to instrumentalities of the Commonwealth at any time. The Bank is not required by law, however, to provide such assistance, and it is the Bank's current policy not to provide financing to instrumentalities of the Commonwealth (other than the central government) unless the Bank is satisfied that these instrumentalities have sufficient revenues to repay such loans. For a discussion of the level and types of loans provided by Government Development Bank to the Commonwealth and its instrumentalities, see *Loans by Government Development Bank to the Commonwealth, Its Public Corporations and Municipalities.*

Because of the role played by Government Development Bank as lender to the Commonwealth and its instrumentalities and the effect that the financial condition of the Commonwealth and its instrumentalities may have on the financial condition and results of operations of Government Development Bank, this Official Statement includes a discussion of recent developments relating to the Commonwealth's budget deficit for fiscal year 2006, its proposed budget for fiscal year 2007 and the Commonwealth's current structural budget imbalance. For the same reason, this Official Statement also incorporates by reference the Commonwealth's Financial Information and Operating Data Report, dated December 1, 2005 (the "Commonwealth Report"), which appears as Appendix I to the Official Statement, dated December 22, 2005, of the Commonwealth of Puerto Rico $1,042,500,000 Tax and Revenue Anticipation Notes, Series 2006, and which sets forth important operating and financial information about the Commonwealth, including information about its economy, historical revenues and expenditures of its General Fund, the preliminary year-end results of fiscal year 2005, the current budget for fiscal year 2006, and the debt of the Commonwealth's public sector. Purchasers of the Series B Notes are advised to read the Commonwealth Report in its entirety. Some of the information appearing in the Commonwealth Report has been updated and appears below in "Recent Developments Relating to the Commonwealth's Budget for Fiscal Year 2006 and its Proposed Budget for Fiscal Year 2007" and "Recent Development Relating to the Commonwealth's Efforts to Resolve its Structural Budget Imbalance" under *Recent Developments Relating to the Commonwealth*.

In October 2005, Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), lowered the Bank's long-term credit rating from BBB+ to BBB, with negative outlook, citing as the reasons therefor the alignment of the Bank's creditworthiness to that of the Commonwealth and the Commonwealth's current fiscal imbalance. On March 22, 2006, S&P placed the Commonwealth's and the Bank's ratings on CreditWatch with negative implications. This recent action with respect to the Bank's rating was a result of the placement of the Commonwealth's rating on CreditWatch with negative implications. On May 8, 2006, Moody's Investors Service, Inc. ("Moody's") downgraded the Commonwealth's general obligation and appropriation bond ratings to "Baa3" from "Baa2" and to "Ba1" from "Baa3," respectively, and kept the ratings on Watchlist for possible further downgrade. Further downgrades of the credit rating of the Commonwealth may result in further downgrades of the credit rating of Government Development Bank. Any such further downgrade could affect the Bank's liquidity and limit its access to capital market funding sources, such as its commercial paper, and certain other alternate funding sources. The Bank, however, believes that it has alternate funding sources. See "Possible Impact of the Commonwealth's Fiscal Imbalance on the Finances of Government Development Bank" and "Liquidity and Sources of Funding" under *Finances of Government Development Bank*. See also "Rating Action Involving the Commonwealth and Government Development Bank" under *Recent Developments Relating to the Commonwealth*.

This Official Statement includes descriptions of Government Development Bank as well as summaries of the terms of the Series B Notes and the Indenture. Such summaries and the references to all documents included herein do not purport to be complete, and each summary and reference is qualified in its entirety by reference to each such document, copies of which are available from the Underwriters prior to the issuance of the Series B Notes and from the Trustee thereafter. All references to the Series B Notes are qualified in their entirety by reference to the definitive forms thereof and the information with respect thereto contained in the Indenture.

Incorporation of Commonwealth Financial Information

This Official Statement incorporates by reference (i) the Commonwealth Report, and (ii) the Comprehensive Annual Financial Report of the Commonwealth for the Fiscal Year ended June 30, 2005, prepared by the Department of the Treasury of Puerto Rico (the "Commonwealth's Annual Financial Report"), which report includes the basic financial statements of the Commonwealth as of and for the fiscal year ended June 30, 2005, which have been audited by KPMG LLP, independent auditors, as stated in their report dated March 14, 2006, accompanying the financial statements. KPMG LLP did not audit the financial statements of the Public Buildings Authority capital project fund (a major fund) and certain activities, funds and component units separately identified in their report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and their opinion in the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, is based solely on the reports of the other auditors. Their report also contains an emphasis paragraph for the adoption of Government Accounting Standards Board (GASB) Statement No. 40, *Deposits and Investment Risk Disclosures*, as of June 30, 2005. The Commonwealth's Annual Financial Report and the Commonwealth Report were filed by the Commonwealth with the Municipal Securities Rulemaking Board (the "MSRB") and with each nationally recognized municipal securities information repository ("NRMSIR").

Any appendix of an official statement of the Commonwealth or of any instrumentality of the Commonwealth filed with each NRMSIR and the MSRB or any other document containing the same information as the Commonwealth Report filed with each NRMSIR after the date hereof and prior to the termination of the offering of the Series B Notes shall also be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained herein or in any of the above-described documents incorporated herein by reference shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained in any other subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

RECENT DEVELOPMENTS RELATING TO THE COMMONWEALTH

The financial condition and results of operations of Government Development Bank, as lender to the Commonwealth and its instrumentalities, may be affected by the financial condition of the Commonwealth and its instrumentalities. This section provides information about the Commonwealth's current fiscal situation which supplements and updates the information appearing in the Commonwealth Report. This section should be read in conjunction with the information and descriptions about the Commonwealth's fiscal situation included in the

Commonwealth Report, which is incorporated by reference hereto and should be read in its entirety.

Recent Developments Relating to the Commonwealth's Budget for Fiscal Year 2006 and the Proposed Budget for Fiscal Year 2007

Fiscal Year 2006 Budget. On March 16, 2005, the Governor submitted to the Legislative Assembly of the Commonwealth a proposed balanced budget of resources and expenditures for fiscal year 2006 providing for General Fund resources and expenditures of $9.684 billion. The Legislative Assembly, which is controlled by the principal opposition political party, however, did not approve the Governor's proposed budget and instead, on June 30, 2005, approved a budget resolution for fiscal year 2006 that provided for General Fund expenditures of $9.258 billion. The Governor vetoed this budget resolution because the revenue measures contained therein, as estimated by the Secretary of the Treasury, were insufficient to cover the budgeted expenditures as required by the Constitution. He did, however, sign into law certain revenue-raising measures approved by the Legislative Assembly estimated to generate approximately $130 million in new revenues. Although the revenue-raising measures contained language conditioning their effectiveness on the approval by the Governor of the $9.258 billion budget resolution, according to the Secretary of Justice these revenue-raising measures are enforceable regardless of such language. Although no legal action has been initiated thus far, no assurance can be given that the effectiveness of such revenue measures will not be challenged.

As a result of the Governor's veto, and in accordance with the Commonwealth's Constitution, the budget for fiscal year 2005 (with certain adjustments) carried over and continued in effect for fiscal year 2006. The Governor, through the adoption of Executive Order 2005-58 on August 30, 2005 (the "Budget 2006 Executive Order"), as amended, made certain additional adjustments to the budget in order to bring the total expenditures in line with the Secretary of the Treasury's estimate of total revenues for fiscal year 2006 of $8.945 billion. These adjustments included, among others, a $384 million reduction related to a portion of debt service for general obligation bonds due during fiscal year 2006 and other debt obligations of the Commonwealth (the "Excluded Debt Service"), which is being paid from a Government Development Bank line of credit already in place and ultimately from the proceeds of a Commonwealth bond issue.

The budget for fiscal year 2005, as adjusted by the Budget 2006 Executive Order, has remained in effect throughout fiscal year 2006. For more details about the content of the budget, see "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in the Commonwealth Report.

Projected Budget Deficit for Fiscal Year 2006. Based on the spending rate experienced during the first nine months of fiscal year 2006, total expenditures for the fiscal year are currently estimated to reach $9.683 billion, exceeding budgeted expenditures of $8.945 billion by approximately $738 million. The excess expenditures are attributable to $434 million of payroll and other related costs, $219 million of health and retirement systems related expenditures, and $85 million of other expenditures. Approximately $362.6 million, or 49.1%, of the estimated budget deficit is due to expenditures in excess of budgeted amounts by the Department of Education, of which $315.5 million, or 87%, is attributable to payroll and related expenses.

The Secretary of the Treasury's most recent estimate of total revenues for fiscal year 2006 is $8.995 billion, which is $50 million more than the original budgeted revenues and also includes $100 million expected to be generated by an interest rate swap transaction. Without considering any additional revenues, certain vendor debts from prior fiscal years referenced below, the Excluded Debt Service, or any other increase in projected expenditures during fiscal year 2006, the difference between the aforementioned spending rate of $9.683 billion and estimated revenues of $8.995 billion results in a budget deficit of approximately $738 million. For a discussion about certain vendor debts of the Commonwealth from prior fiscal years, see "Summary and Management's Discussion of General Fund Results – Commonwealth's Budget Structural Imbalance" under *Puerto Rico Taxes, Other Revenues, and Expenditures* and "2006 Budget Approval Process" under *Budget of the Commonwealth of Puerto Rico* in the Commonwealth Report.

Due to the expected budget deficit, the Commonwealth was unable to meet certain of its operating expenditures, including payroll, commencing on May 1, 2006. In order to address the budget deficit for fiscal year 2006 and meet the Commonwealth's payroll obligations, the Governor proposed legislation authorizing Government Development Bank to finance $638 million of the Commonwealth's budget deficit for fiscal year 2006. This loan, which required legislative approval, would be payable from additional revenues generated by the proposed new consumption tax, which is discussed below. The remaining portion of the budget deficit for fiscal year 2006 would be covered with funds available in the Budgetary Fund, the Emergency Fund, and additional expenditure reductions.

On April 25, 2006, the Senate approved a loan in the principal amount of approximately $531.5 million instead of the $638 million loan proposed by the Governor, but the House of Representatives did not because the Speaker of the House of Representatives (the "Speaker of the House") believes the Commonwealth has alternate means of covering the budget deficit.

On April 26, 2006, the Governor signed an executive order allocating the Commonwealth's remaining revenues to those central government agencies that offer essential services (the "Deficit Executive Order"). Specifically, the Deficit Executive Order stated that during May and June, 2006, the Secretary of the Treasury could only make the following disbursements: (i) 46% of projected payroll to the Executive Branch, (ii) 50% of projected payroll to the Legislative Branch, (iii) 75% of projected payroll for each of the Judiciary and the Office of the Comptroller, (iv) 75% of the Governmental Ethics Office's remaining disbursements, and (v) 25% of the University of Puerto Rico's remaining disbursements. Furthermore, the Deficit Executive Order stated that the Municipal Revenues Collection Center would not receive any of its remaining disbursements of about $60 million and prohibited any disbursements for the acquisition of goods or services unless authorized by the Governor's chief of staff.

The Deficit Executive Order took effect on May 1, 2006 and, as a result, certain non-essential services offered by government agencies and department, including public schools, were suspended. Approximately 95,000 public employees were granted an unpaid leave of absence until such time as the Commonwealth was provided with sufficient resources to cover remaining expenditures for fiscal year 2006.

On May 8, 2006, the Governor of Puerto Rico, the President of the Senate and the Speaker of the House appointed a special, four member committee (the "Committee") which was given the task of: (i) resolving the impasse between the Executive Branch and the Legislative Assembly with respect to ending the partial shutdown of government agencies that began on May 1, 2006 and addressing the budget deficit of the Commonwealth for fiscal year 2006, and (ii) evaluating measures designed to provide a long-term solution to the Commonwealth's structural budget imbalance. On May 10, 2006, the Committee recommended that, on or prior to May 15, 2006, the Legislative Assembly: (i) adopt measures designed to end the partial government shutdown and allow the Commonwealth to compensate the 95,000 public employees who were granted an unpaid leave of absence, and (ii) approve a loan by the Bank to the Commonwealth of up to $741 million to finance the budget deficit for fiscal year 2006. As a compromise between previous proposals, the Committee recommended that a portion of such loan be payable from the proceeds of certain new, non-recurring tax measures to be enacted by the Legislative Assembly. The Legislative Assembly estimates that these measures will generate over $200 million. The remaining balance of the $741 million loan will be payable from the proceeds of a 1% portion of the consumption tax proposed to be enacted, which portion would be earmarked for the payment of the Commonwealth's appropriation debt, as mentioned below.

The Committee also recommended the enactment, on or prior to June 30, 2006, of: (i) legislation allocating a 1% portion of the consumption tax for the payment of the Commonwealth's appropriation debt, and (ii) a comprehensive tax reform and a fiscal reform consistent with the proposals set forth in Joint Resolution No. 321 of November 21, 2005. See "Recent Developments Relating to the Commonwealth's Efforts to Resolve the Structural Budget Imbalance – House Joint Resolution and Governor's Executive Order" below. The Committee also recommended giving priority to legislation that will reduce the size and expenses of the government and provide for the financial needs of the municipal governments and the retirement systems through the transfer of assets and any budget surplus resulting from the tax reform.

On the same day, the Governor, the President of the Senate and the Speaker of the House announced their acceptance of the Committee's recommendations and stated they would act upon such recommendations.

On May 12, 2006 the Legislative Assembly approved, and on May 13, 2006 the Governor signed, legislation authorizing the Bank to lend up to $741 million to finance the Commonwealth's budget deficit for fiscal year 2006. This action allowed the Commonwealth to resume full government operations on May 15, 2006. The Legislative Assembly also approved and the Governor signed legislation creating an Urgent Needs Fund to be funded by a 1% portion of the consumption tax proposed to be enacted and used exclusively to pay debt service on appropriation debt, including the aforementioned loan. Any future budget surplus will also be deposited in the Urgent Needs Fund and will be used to cover the cost of certain early retirement programs and amortize the Commonwealth's debt with the Teachers Retirement System, the Employees Retirement System and the Judiciary Retirement System, in that order.

In order to address the Commonwealth's structural budget imbalance, the previously mentioned legislation also provides for the approval of: (i) additional recurring revenue measures estimated to provide a net tax revenue increase of approximately $300 to $400 million annually, and (ii) a three-year expenditure reduction program expected to generate savings in the

Executive Branch of at least $350 million per year. The parties, however, must still reach an agreement as to a specific consumption tax rate and tax relief measures to be implemented as part of the tax reform as well as the provisions of the fiscal reform. Although the President of the Senate and the Speaker of the House have announced their intention of adopting a comprehensive tax reform and fiscal reform on or prior to June 30, 2006, there is no assurance that the comprehensive tax reform and the fiscal reform will be enacted and, if enacted, that such measures will generate the projected revenues or savings.

Fiscal Year 2007 Proposed Budget. On April 3, 2006, the Governor submitted to the Legislative Assembly a proposed balanced budget of resources and expenditures for fiscal year 2007 providing for General Fund resources and expenditures of $9.684 billion. The amount of total expenditures included in the proposed budget is essentially the same as the current estimated total expenditures of $9.683 billion for fiscal year 2006 and the total expenditures originally proposed by the Governor for the fiscal year 2006 budget. The proposed budget assumes the enactment, on or prior to June 30, 2006, of a comprehensive tax reform which would increase General Fund revenues by approximately $689 million through the replacement of the 5% general excise tax with a 7%, broad-based tax on the retail sale of articles of use and consumption (the "consumption tax") and the reduction of certain income tax rates. Although the Executive Branch and the Legislative Assembly agree that a comprehensive tax reform is necessary, at present there is disagreement as to some of the details of the tax reform, in particular the rate of the consumption tax. See "Recent Developments Relating to the Commonwealth's Efforts to Resolve the Structural Budget Imbalance" below. There is no assurance that a comprehensive tax reform will be enacted and, if enacted, that it will be implemented in time to achieve projected revenues for fiscal year 2007.

In May 2006, the Speaker of the House announced that the House of Representatives is currently analyzing the Governor's proposed budget for fiscal year 2007. The Speaker of the House indicated that a budget for fiscal year 2007 will be approved on or prior to June 30, 2006.

Fiscal Year 2007 Revenue Estimate. The Secretary of the Treasury's estimate of total revenues for fiscal year 2007 of $9.684 billion represents an increase of $689 million, or 7.6%, over the estimate of total revenues for fiscal year 2006 of $8.995 billion. The estimate of total revenues for fiscal year 2007 includes: (i) an increase in total tax collections of approximately $776 million, (ii) a decrease in income tax collections of approximately $66 million, and (iii) a decrease in total excise tax collections of approximately $607 million. The estimate of total revenues for fiscal year 2007 assumes, among others, (a) the enactment, on or prior to June 30, 2006, of a comprehensive tax reform that would reduce certain income tax rates and substitute the 5% general excise tax with a 7% consumption tax, (b) real growth of 2.5% in gross national product, and (c) the expansion of the tax base.

The imposition of a 7% consumption tax is estimated to generate approximately $2.15 billion in additional revenues. The Governor, however, has proposed earmarking approximately $307 million, or 1% of the 7% consumption tax, for the payment of the Commonwealth's appropriation debt and loans with the Bank, and approximately $461 million, or 1.5% of the 7% consumption tax, to be apportioned amongst the Commonwealth's municipalities. Therefore, the estimate of additional General Fund revenues for fiscal year 2007 includes approximately $1.38 billion, or 4.5% of the 7% consumption tax. On May 12, 2006, the Legislative Assembly approved the Governor's proposal of earmarking 1% of any future consumption tax for the payment of the Commonwealth's appropriation debt and loans with the Bank. For a discussion of the tax reform proposals being considered by the Legislative Assembly, see "Recent Developments Relating to the Commonwealth's Efforts to Resolve the Structural Budget Imbalance – Proposed Tax Reform" below.

If a comprehensive tax reform (as proposed by the Governor) is not enacted by the Legislative Assembly, the Secretary of the Treasury estimates that total revenues for fiscal year 2007 would be $9.188 billion. According to the proposed budget package, this would represent a budget imbalance of approximately $496 million, which would have to be addressed by new revenue raising measures (which may require legislative approval), additional non-recurring revenues or additional expenditure reductions. Also, delays in the implementation of a comprehensive tax reform could result in a budget imbalance for fiscal year 2007.

Commonwealth's Structural Budget Imbalance. The budget imbalance in fiscal year 2006 comes in the wake of several recent fiscal years during which the Commonwealth had insufficient recurring revenues to cover its recurring expenditures. These budget imbalances have been covered in the past with loans from Government Development Bank, financing transactions (including long-term bond issues payable from the General Fund) and other non-recurring resources. The Commonwealth estimates that during fiscal year 2006 its recurring operating expenditures will exceed recurring revenues (the so-called structural imbalance) by approximately $1.2 billion, compared to $1 billion for fiscal year 2005. This amount represents the difference between estimated expenditures of $9.683 billion plus the Excluded Debt Service ($384 million), for a total of $10.1 billion, less recurring revenues of $8.895 billion (which includes approximately $50 million in additional revenues but excludes $100 million expected to be generated by an interest rate swap transaction which has not yet been carried out). The Commonwealth expects to reduce this imbalance by financing the Excluded Debt Service ($384 million), entering into the interest rate swap transaction, and, as discussed above, financing most of the remaining portion of the Commonwealth's fiscal year 2006 budget deficit with a loan from Government Development Bank.

In addition to certain vendor debts from prior fiscal years, estimated amounts required to cover maintenance expenses incurred by Public Buildings Authority ("PBA") (approximately $75 million) and subsidy and operational expenses incurred by the Agricultural Services and Development Administration ("ASDA") (approximately $75 million) are being covered by lines of credit from Government Development Bank collateralized by real estate and accounts receivable, with payment expected from the sale of such pledged real estate and/or the collection of such pledged receivables.

Other Fiscal Challenges. The Commonwealth faces other fiscal challenges besides its current budgetary issues. The principal one involves resolving the increasing unfunded pension liability of the Employees Retirement System and the Teachers Retirement System. The Commonwealth expects to reduce the unfunded liability of the Employees Retirement System based on proposed legislation which provides for increased employer and employee contributions and the issuance of up to $2 billion of pension obligation bonds, which would be payable from the Commonwealth's General Fund. The Employees Retirement System and the Teachers Retirement System are also seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits. Part of these claims by the Teachers Retirement System ($119 million) is not recognized by OMB as a Commonwealth liability and the difference is currently under inter-agency arbitration. Other claims ($78 million for fiscal year 2005 and prior years and $43 million for fiscal year 2006) are under consideration by OMB to determine the final amount that the Commonwealth may owe the Employees Retirement System. For more details, see *Retirement Systems* in the Commonwealth Report.

Recent Developments Relating to the Commonwealth's Efforts to Resolve the Structural Budget Imbalance

In response to the Commonwealth's General Fund deficits over the last several fiscal years and the anticipated deficit for fiscal year 2006, during the second half of fiscal year 2005 and the first half of fiscal year 2006 the Commonwealth took certain legislative and executive actions aimed at establishing the basis for a comprehensive tax and fiscal spending reform. See "Summary and Management's Discussion of General Fund Results – Commonwealth's Structural Budget Imbalance" under *Puerto Rico Taxes, Other Revenues, and Expenditures* in the Commonwealth Report. The combination of those actions, designed to increase recurring revenues and control government spending, is intended to eliminate the Commonwealth's structural budget deficit within several years. There is no assurance, however, that the structural imbalance will be corrected by such date.

Below is a discussion of the actions taken so far and those proposed to be taken by the Commonwealth to address its budget imbalance and other fiscal challenges faced by the Commonwealth.

House Joint Resolution and the Governor's Executive Order. On November 21, 2005, as a result of a joint effort by the two principal political parties to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Legislative Assembly approved, and the Governor signed, Joint Resolution No. 321 (the "Joint Resolution"). On the same day, the Governor issued an Executive Order implementing the fiscal measures defined in the Joint Resolution (the "Fiscal Reform Executive Order"). The Joint Resolution and the Fiscal Reform Executive Order impose government-wide expenditure controls and set forth the basic principles that would govern the reform of the Commonwealth's tax system and fiscal spending policy and practices. The proposed tax reform is aimed at increasing revenues by expanding the tax base through the implementation of the consumption tax. The proposed fiscal reform was aimed at limiting the growth of expenditures in relation to past spending rates and stabilizing expenditure growth to a level below that of recurring revenues.

The Joint Resolution and the Fiscal Reform Executive Order came in the wake of expenditure controls previously implemented during fiscal year 2006 by the Governor, such as a reduction of appointed government positions, a limitation on the creation of new temporary employee positions, a hiring freeze, and a voluntary work week reduction program, as well as limitations on central government vehicle fleets and other expenses. General Fund savings as a result of the implementation of these savings measures are currently estimated at $115 million.

Proposed Tax Reform. In general terms, the proposed tax reform is expected to (i) broaden the tax base through the implementation of a consumption tax, (ii) reduce certain individual income taxes, and (iii) simplify the administration of the tax system. On November 16, 2005, legislation with respect to the tax reform, including a 7% consumption tax, was introduced in the House of Representatives with a proposed effective date of July 1, 2006. On January 16, 2006, the Governor presented his own tax reform proposal to the Legislative Assembly. The Governor's principal proposals, which include the replacement of the Commonwealth's excise tax with a 7% consumption tax, the elimination or reduction of many existing income tax deductions, and reductions in the existing income tax rates, were substantially similar to the principal proposals of the Joint Resolution.

The Governor's tax reform proposal includes the substitution of the 5% general excise tax with a 7% consumption tax and the earmarking of 1.5% for transfer to the Commonwealth's municipalities and 1% for the payment of the Commonwealth's appropriation debt. See "Recent Developments Relating to the Commonwealth's Budget for Fiscal Year 2006 and the Proposed Budget for Fiscal Year 2007 – Fiscal Year 2007 Revenue Estimate" above. Currently, the Commonwealth's yearly debt service on its appropriation debt is approximately $532 million. The Commonwealth expects to refinance and restructure part of the appropriation debt in order to reduce its yearly debt service to approximately $300 million, which is the amount earmarked for debt payments under the Governor's proposal. The Secretary of the Treasury expects that the tax reform proposed by the Governor will provide a net increase in the General Fund's annual revenues, after taking into consideration proposed reductions in income taxes and the earmaking of certain of the consumption tax revenues as described above. This net increase in annual revenues, and their future growth based on economic growth, together with savings achieved through the implementation of fiscal spending controls and the reduction of annual debt service on the Commonwealth's outstanding appropriation debt, is expected to reduce and eliminate the structural imbalance by fiscal year 2009.

While the Executive Branch and the Legislative Assembly agree that a comprehensive tax reform must be enacted, there is disagreement as to the specifics of such tax reform, particularly whether the aggregate consumption tax rate should be 5.5% or 7%. Certain members of the Legislative Assembly proposed a tax rate of 4%, repeal of the 5% general excise tax and enactment of an additional consumption tax of 1.5% at the municipal level, as well as the implementation of various savings measures to reduce General Fund expenditures. The Secretary of the Treasury expects this proposal will provide a net increase in annual General Fund revenues but estimates that under this proposal the structural imbalance will not be eliminated by fiscal year 2009.

Proposed Fiscal Reform. The Joint Resolution and the Fiscal Reform Executive Order also set forth guiding principles and impose certain expenditure controls as part of fiscal reform. The Joint Resolution and the Fiscal Reform Executive Order restrict the use of layoffs of government employees as a means to reduce government expenditures, and impose a government hiring freeze and other measures to reduce headcount until the structural budget deficit has been eliminated. Fiscal discipline will also be promoted by requiring each central government agency to implement a seven-year expense reduction plan, adopting a new public policy that distinguishes between unnecessary and indispensable expenses, enacting certain limitations on the use of the Budgetary Fund, and providing that the budget may only be balanced through the use of recurring revenues. The proposed fiscal reform also mandates the reduction of advertising and travel expenses, promotes the use of electronic communications and document delivery, caps the purchase price of each government vehicle, and limits other non-payroll expenditures. Furthermore, the Legislative Assembly must approve any borrowings by the Secretary of the Treasury in order to finance any Commonwealth budget deficit with debt securities that are not repaid during the same fiscal year in which they are issued.

The Joint Resolution also includes a long-term plan to reduce and improve the management of the Commonwealth's public debt and recent proposals have recommended the creation of an Urgent Needs Fund, providing that 1% of the proposed consumption tax be set aside in this fund initially to pay debt service on appropriation backed bonds directly, without flowing through the General Fund.

On January 26, 2006, the Governor outlined his fiscal reform proposal, which imposes stricter controls on government expenditures and reinforces the savings measures implemented by the Fiscal Reform Executive Order. The Governor's fiscal reform proposal also includes various measures, the passage of which require approval by the Legislative Assembly. Subsequently, in May 2006, legislation was approved by the Legislative Assembly that would make into law most of the expenditure controls set forth in the Joint Resolution and the Fiscal Reform Executive Order. This legislation has not been signed by the Governor. There is no assurance, however, that these proposals will be finally enacted and, if enacted, that they will produce significant savings for the General Fund.

Rating Action Involving the Commonwealth and Government Development Bank

Recent Rating Action. On May 8, 2006, Moody's Investors Service, Inc. ("Moody's") downgraded the Commonwealth's general obligation and appropriation bond ratings to "Baa3" from "Baa2" and to "Ba1" from "Baa3," respectively, and kept the ratings on Watchlist for possible further downgrade. Moody's action reflected the Commonwealth's strained financial condition, ongoing political conflict and lack of agreement regarding the measures necessary to end the government's multi-year trend of financial deterioration.

Previous Rating Action. On February 24, 2006, Moody's placed the Commonwealth's general obligation rating of "Baa2" on its Watchlist for review and possible downgrade. Moody's also placed on its Watchlist all other bonds issued by various Commonwealth instrumentalities whose credit is directly or indirectly linked to that of the Commonwealth. On May 2, 2006, Moody's issued a report in response to the partial shutdown of the Commonwealth's government. In the report, Moody's stated that a prolonged political stalemate with respect to the resolution of the Commonwealth's budget deficit for fiscal year 2006 will have negative ratings implications.

On March 22, 2006, S&P placed the Commonwealth's rating on CreditWatch with negative implications as a result of the Commonwealth's anticipated budget deficit for fiscal year 2006, slow progress on tax and fiscal reform and the apparent political impasse regarding these measures. On that same day, S&P placed the Bank's rating on CreditWatch with negative implications due to the alignment of the Bank's rating with that of the Commonwealth, as described below. S&P may take further rating action on or prior to June 30, 2006.

On October 21, 2005, S&P further lowered Government Development Bank's long-term counterparty credit and CD rating to "BBB" from "BBB+" and affirmed Government Development Bank's short-term counterparty rating of "A-2." S&P lowered Government Development Bank's long-term counterparty rating in order to further align Government

Development Bank's credit to that of the Commonwealth. The reasons cited for the alignment include the higher balance of public sector loans on Government Development Bank's balance sheet, the Commonwealth's continued reliance on Government Development Bank loans, and Government Development Bank capital distributions to the Commonwealth in the form of dividends and other special appropriations.

The Commonwealth and Government Development Bank have each been assigned a negative ratings outlook reflecting the Commonwealth's anticipated 2006 budget imbalance and the higher balance of public sector loans in Government Development Bank's asset mix. S&P also indicated that should financial stress at the Commonwealth level negatively affect Government Development Bank's financial profile by weakening its liquidity or capital position, its debt ratings could be lowered.

USE OF PROCEEDS

Government Development Bank will use the proceeds from the sale of the Series B Notes to provide a new source of funding for lines of credit provided to certain government agencies and public corporations (collectively, the "Benefited Entities") in order to finance such borrowers' capital improvement programs.

THE SERIES B NOTES

General

The Series B Notes will be dated their date of issuance and will mature (subject to prior redemption as described below) on such dates and in such amounts as set forth on the inside cover page of this Official Statement. The Series B Notes will be issued as fully registered notes without coupons, in denominations of $5,000 principal amount and integral multiples thereof.

Interest on the Series B Notes will accrue from their date of issuance at the rates set forth on the inside cover page of this Official Statement and will be paid semi-annually on each June 1 and December 1, commencing on December 1, 2006, until maturity or prior redemption. Interest on the Series B Notes will be computed on the basis of a 360-day year consisting of twelve 30-day months.

Book-Entry Only System

The following information concerning The Depository Trust Company ("DTC"), New York, New York and DTC's book-entry system has been obtained from DTC. Neither the Commonwealth nor the Underwriters take any responsibility for the accuracy thereof.

DTC will act as securities depository for the Series B Notes. The Series B Notes will be issued as fully registered notes registered in the name of Cede & Co. (DTC's partnership nominee) or such other nominee as may be requested by an authorized representative of DTC. One fully registered Series B Note will be issued for each maturity of the Series B Notes, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

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

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

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

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

Redemption notices shall be sent to DTC. If less than all of the Series B Notes within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

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

Principal, redemption premium, if any, and interest payments on the Series B Notes will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from Government Development Bank, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, its nominee, or Government Development Bank, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, redemption premium, if any, and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of Government Development Bank, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Series B Notes at any time by giving reasonable notice to Government Development Bank or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, definitive note certificates will be printed and delivered.

Government Development Bank may decide to discontinue use of the system of book-entry only transfers through DTC (or a successor depository). In that event, definitive note certificates will be printed and delivered.

Payments and Transfers

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

For every transfer and exchange of the Series B Notes, the Beneficial Owners may be charged a sum sufficient to cover any tax, fee or other charge that may be imposed in relation thereto.

Discontinuance of the Book-Entry Only System

In the event that the book-entry only system is discontinued, the following provisions will apply: principal of and redemption premium, if any, on the Series B Notes shall be payable in lawful money of the United States of America at the principal office of the Trustee in San Juan, Puerto Rico. Interest on the Series B Notes will be payable by check mailed to the respective addresses of the registered owners determined as of the 15th day of the month preceding the interest payment date as shown on the registration books of Government Development Bank maintained by the Trustee. The Series B Notes will be issued only as registered notes without coupons in denominations of $5,000 or any integral multiple thereof. The transfer of the Series B Notes will be registrable and they may be exchanged at the corporate trust office of the Trustee in San Juan, Puerto Rico, upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Optional Redemption

The Series B Notes maturing on or prior to December 1, 2016 are not subject to redemption prior to maturity. The Series B Notes maturing after December 1, 2016 are subject to redemption prior to maturity, either in whole or in part (and if in part, in such order of maturity as the Bank shall determine), on any date selected by Government Development Bank occurring not less than 45 days after the date the notice of redemption is received by the Trustee, at a redemption price equal to the principal amount thereof, plus accrued interest to the redemption date, without premium. The earliest possible date of redemption is December 1, 2016.

Notice and Effect of Redemption; Partial Redemption

Any redemption of the Series B Notes, either in whole or in part, shall be made upon at least 30 day's prior notice by mail to DTC or, if the book-entry only system described above has been discontinued, by first-class mail, postage prepaid, to all registered owners of the Series B Notes to be redeemed in the manner and under the terms and conditions provided in the Indenture. On the date designated for redemption, notice having been given as provided in the Indenture and moneys for payment of the principal of and accrued interest on the Series B Notes or portions thereof so called for redemption being held by the Trustee, interest on the Series B Notes or portions thereof so called for redemption shall cease to accrue.

Each notice of redemption shall contain, among other things, a description of the particular Series B Notes (or portions thereof) being called for redemption, the redemption date and price and the address at which such Series B Notes are to be surrendered for payment of the redemption price. Any defect in such notice or the failure so to mail any such notice to DTC in respect of, or the registered owner of, any Series B Note will not affect the validity of the proceedings for the redemption of any other Series B Note.

If less than all the Series B Notes of any maturity are called for redemption, the particular Series B Notes so called for redemption shall be selected by the Trustee by such method as it deems fair and appropriate, except that so long as the book-entry only system shall remain in effect, in the event of any such partial redemption, DTC shall reduce the credit balances of the applicable DTC Participants in respect of the Series B Notes and such DTC Participants shall in turn select those Beneficial Owners whose ownership interests are to be extinguished by such partial redemption, each by such method as DTC or such DTC Participant, as the case may be, in its sole discretion, deems fair and appropriate.

Notes are Unsecured Obligations of Government Development Bank

The Notes are general, unsecured, senior obligations of the Bank, ranking on a parity with all other general, unsecured and unsubordinated obligations of the Bank for borrowed money and with unsecured and unsubordinated Government Development Bank guarantees of obligations of others for borrowed money now or hereafter outstanding. Neither the good faith, credit and taxing power of the Commonwealth nor that of any of its political subdivisions or instrumentalities, other than Government Development Bank, will be pledged for the payment of the Notes.

Availability of Assets of Government Development Bank's Subsidiaries for Payment of the Notes

Because the Notes are issued by Government Development Bank and are not guaranteed by the Bank's subsidiaries, holders of the Notes will not have recourse against the Bank's subsidiaries. As of December 31, 2005, approximately $2.2 billion out of Government Development Bank's consolidated total assets of $10.4 billion were held by the Bank's subsidiaries and are, therefore, unavailable for the payment of debt service on the Notes.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

Organization and Powers

Government Development Bank is a public corporation and governmental instrumentality of the Commonwealth of Puerto Rico created by Act No. 17 of the Legislature of Puerto Rico, approved September 23, 1948, as amended (the "Charter"). The Charter provides that the Bank's existence will be perpetual, and that no amendment to the Charter, or to any other law of the Commonwealth, will impair any outstanding obligation or commitment of the Bank. Under its Charter, the Bank has the power, among other things, to borrow money, to issue its bonds, notes, debentures, and other obligations, to lend money to and purchase obligations issued by the Commonwealth, its agencies and instrumentalities, to lend money to any other person when such moneys are to be used to develop the economy of Puerto Rico, and to sue and be sued.

Government Development Bank is generally exempt from Commonwealth taxation. It is required to have an annual examination and audit by certified public accountants of national reputation selected by its Board of Directors (the "Board of Directors"). As in the case of all Commonwealth banks, it is subject to examination and supervision by the Commissioner of Financial Institutions of the Commonwealth. The Comptroller of the Commonwealth, who is responsible to the Legislature, usually reviews the Bank's operations every two to three years.

Principal Functions

The Bank's principal function is to act as fiscal agent, financial advisor and lender to the Commonwealth, its agencies, public corporations and municipalities. In its role as fiscal agent, it acts as advisor to the Commonwealth and its instrumentalities in connection with all their borrowings, and all such borrowings are subject to the Bank's prior approval. Government Development Bank receives fees for rendering such services.

Government Development Bank lends to, and purchases and guarantees certain obligations of, the Commonwealth and its agencies, public corporations and municipalities. It provides interim financing to these entities in anticipation of their refinancing such indebtedness in the bond market and also provides longer term financing to such entities. In fiscal years 2005, 2004 and 2003, Government Development Bank disbursed individual lines of credit and other financing facilities to the public sector in aggregate amounts of approximately \$6.8 billion, \$6.3 billion and \$3.4 billion, respectively. As of December 31, 2005, the corresponding amount disbursed by Government Development Bank during fiscal year 2006 was \$3 billion. For a breakdown of the outstanding principal amount of Government Development Bank's loans to the public sector, see the table appearing in "General" under *Loans by Government Development Bank to the Commonwealth, its Public Corporations and Municipalities*.

Government Development Bank also lends to the private sector, mainly through its subsidiaries, Tourism Development Fund and Housing Finance Authority. For a description of the Bank's loans to the private sector, see the information for Housing Finance Authority and Tourism Development Fund in "Subsidiaries" under *Government Development Bank for Puerto Rico* and *Loans by Government Development Bank to Private Enterprises*. From time to time, the Bank also issues letters of credit to guarantee obligations of private lenders with respect to financing arrangements that promote the development of the Commonwealth's economy.

Management

Government Development Bank is governed by a seven member Board of Directors appointed by the Governor of the Commonwealth with the approval of the Council of Secretaries. The Board of Directors consists of the following members serving terms as indicated:

Member	Occupation	Expiration Date
Alfredo Salazar Conde, Chairman	Private Investor	September 22, 2008
José F. Rodríguez Perelló, Vice Chairman	Private Investor	September 20, 2008
Juan Carlos Méndez	Secretary of the Treasury	September 22, 2008
Jorge Silva Puras	Secretary of Economic Development and Commerce	September 22, 2006
Ileana Fas Pacheco	Director of the Office of Management and Budget	September 22, 2007
Rafael Martínez Margarida	Certified Public Accountant	September 22, 2006
Ernesto A. Meléndez	Attorney	September 22, 2007

The Board of Directors appoints a President who is the chief executive officer of Government Development Bank and is responsible for its day to day operations. Government Development Bank also has four executive vice presidents who are in charge of the Bank's principal operational and business units. The following are the Bank's principal officers:

Alfredo Salazar Conde became Acting President effective on August 19, 2005. Mr. Salazar is a private investor with over 30 years of experience in commercial and investment banking. Mr. Salazar served as President of Government Development Bank from 1975 to 1976 and as Executive Director of the Puerto Rico Industrial Development Company during 1990. Mr. Salazar has a Bachelor's degree in economics from Villanova University and pursued post-graduate studies in finance at New York University and Harvard Business School.

Jorge Irizarry has been Executive Vice President and Director of Financing since April 2005. Mr. Irizarry has over 30 years of experience in banking, investments, and consulting, which he acquired while working at Chase Manhattan, Booz Allen Hamilton, Inc., Banco Mercantil, Banco de Ponce, PaineWebber, Inc., and Sandoval Associates. Mr. Irizarry has a Bachelor's degree in finance from New York University and holds a Master's in Business Administration from Harvard Business School.

Hugo Díaz Molini has been Executive Vice President and Treasurer since August 2002. Mr. Díaz has worked for nearly 20 years in treasury and investments within the Puerto Rico private banking sector. Mr. Díaz holds a Master's in Business Administration from the Inter-American University of Puerto Rico.

José Guillermo Dávila Matos, CPA has been Executive Vice President and Director of Administration and Operations since May 2004. Mr. Dávila has 32 years of accounting experience related to manufacturing, distribution, telecommunications, and government. During 1993, Mr. Dávila was president of the Puerto Rico Association of Certified Public Accountants. Mr. Dávila has a Bachelor's degree in business administration, with a concentration in accounting, from the University of Puerto Rico.

María de Lourdes Rodríguez, Esq. has been Executive Vice President and Chief Legal Counsel since October 2003. Ms. Rodríguez has over 20 years of experience in general corporate law, including representation of financial institutions in commercial lending transactions, real estate financings and refinancing, mergers and acquisitions, and environmental law. Ms. Rodríguez is a graduate of The Catholic University of America, Washington, D.C., and the University of Puerto Rico School of Law.

As of December 31, 2005, Government Development Bank, its subsidiaries and affiliates had approximately 552 employees, of which 215 were members of the Union of Employees of Government Development Bank for Puerto Rico.

The main offices of Government Development Bank are located at Roberto Sánchez Vilella Government Center, De Diego Avenue, P.O. Box 42001, San Juan, Puerto Rico 00940, and its telephone number is (787) 722-2525. Government Development Bank also maintains an office at 666 Fifth Avenue, 15th Floor, New York, NY 10103-1599, telephone (212) 422-6420.

Subsidiaries

Government Development Bank has several subsidiaries which perform various functions. The principal subsidiaries and their functions are listed below:

Housing Finance Authority. Housing Finance Authority (formerly known as Housing Finance Corporation) was created to provide needed rental housing units and stimulate the construction industry under federally subsidized programs. Effective February 8, 2002, Housing Finance Corporation became the Housing Finance Authority and the Housing Bank and Finance Agency was dissolved and its powers transferred to the Housing Finance Authority. Housing Finance Authority provides financing for rental housing units, stimulates the construction industry under federally subsidized programs and provides interim financing for low-income housing projects and single-family homeownership programs. It is also engaged in insuring and servicing mortgages originated by the former Housing Bank and Finance Agency. As of December 31, 2005, Housing Finance Authority's total outstanding loans to the private sector for development of housing projects targeted to low-and moderate income families was $76.5 million. The Authority's mortgage loans to low and moderate income homeowners represented an additional $99.2 million as of the same date.

Housing Finance Authority has outstanding tax-exempt revenue bonds and notes that were issued to finance the construction of housing units approved for federal rental subsidies and to finance home ownership of single family housing units. Such bonds and notes are generally limited obligations of Housing Finance Authority payable solely from revenues collected from such housing units, with certain exceptions. As of December 31, 2005, $669.6 million of Housing Finance Authority bonds and notes were outstanding.

As of December 31, 2005, the Authority also had outstanding $585.4 million of bonds and notes issued to fund certain payments of the Commonwealth under its mortgage subsidy and other programs for low and moderate income families, and to guarantee certain insurance obligations of the former Housing Bank and Finance Agency.

As of December 31, 2005, the Authority had total notes and bonds outstanding of $1.4 billion (including $147.9 million of debt outstanding under Government Development Bank lines of credit) and total unrestricted net assets of $565.8 million.

Tourism Development Fund. The Tourism Development Fund was created in November 1993 to promote Puerto Rico's hotel and tourism industry by making available direct loans and guarantees to secure the payment of private financing used for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments in tourism related projects. As of December 31, 2005, the Tourism Development Fund had outstanding direct loans in an aggregate principal amount of $269.7 million and guarantees issued in the outstanding amount of $166.1 million to finance several hotels and tourism-related projects.

The Tourism Development Fund has made payments under its guarantees and letters of credit in the aggregate amount of approximately $313.4 million with respect to several projects, including $282 million disbursed to pay in full the bonds issued to finance three projects, which bonds had been declared due and payable at the direction of the Tourism Development Fund due to the failure of the borrowers of such projects to comply with their obligations under the related reimbursement agreements. Of the total amount disbursed, the Tourism Development Fund has been able to recover approximately $199.7 million from the borrowers. After taking these payments and all related recoveries into consideration, the unrestricted net assets of the Tourism Development Fund as of December 31, 2005, were approximately $100.4 million, and its allowances for losses on guarantees, loans, other real estate owned and letters of credit were approximately $36.8 million.

Capital Fund. The Government Development Bank for Puerto Rico Capital Fund (the "Capital Fund") was created in November 1992 for the purpose of investing and trading in debt obligations and publicly traded shares of domestic and foreign corporations separate from Government Development Bank's general investment operations. As of December 31, 2005, the Capital Fund had assets of $75.3 million, of which $75.1 million were invested in an equity index fund that invests mainly in growth stocks.

Development Fund. The Puerto Rico Development Fund (the "Development Fund") was established in April 1977 to provide an alternate source of financing to private enterprises in Puerto Rico that have difficulties in obtaining financing from traditional sources. The Development Fund is also authorized to guarantee obligations of these enterprises and invest in their equity securities. As of December 31, 2005, the Development Fund had $21.5 million in such investments. The Development Fund proposes to sell most of its assets to the Economic Development Bank for Puerto Rico. This transaction is expected to close in May 2006.

Public Finance Corporation. Puerto Rico Public Finance Corporation ("Public Finance Corporation") was established in November 1984 to provide agencies and instrumentalities of the Commonwealth with alternate means of meeting their financing requirements. Public Finance Corporation currently holds notes payable by the Commonwealth, the Maritime Shipping Authority, the Office for the Improvement of Public Schools, the Department of Health, and the Aqueduct and Sewer Authority, among others. As of December 31, 2005, Public Finance Corporation had $4.4 billion aggregate principal amount of bonds outstanding. All such bonds are limited non-recourse obligations of Public Finance Corporation payable solely from Commonwealth appropriations made to pay the notes held by Public Finance Corporation.

FINANCES OF GOVERNMENT DEVELOPMENT BANK

General

The tables that follow provide financial information of Government Development Bank. Except as otherwise specified, such financial information is presented on a consolidated basis. The Bank's subsidiaries, however, are not responsible for the payment of the Bank's debt, including the Notes. See "Notes are Unsecured Obligations of Government Development Bank" under *The Notes.*

The financial information set forth below is presented in accordance with the requirements of Governmental Accounting Standards Board Statement No. 34 ("GASB 34"). Financial information as of and for the year ended June 30, 2005, 2004 and 2003 was derived from the Bank's audited financial statements. This information should be read together with the Bank's Financial Statements for the year ended June 30, 2005, included as *Appendix I* to this Official Statement.

Government Development Bank's activities consist of governmental and business-type activities. Governmental activities are generally financed through taxes, intergovernmental revenues, and government appropriations. Business-type activities are financed in whole or in part by fees charged to third parties for goods or services. Housing Finance Authority, a subsidiary of Government Development Bank, accounts for all of Government Development Bank's governmental activities. Except where otherwise noted, the following tables include both governmental and business-type activities.

Consolidated Schedule of Net Assets

Set forth below is the consolidated Schedule of Net Assets of Government Development Bank and its subsidiaries as of June 30, 2005, 2004 and 2003, which has been derived from the Bank's audited financial statements, and as of December 31, 2005 and 2004, which has been derived from the Bank's unaudited financial statements. The consolidated Schedule of Net Assets provides information on the assets and liabilities of Government Development Bank and its subsidiaries, and includes both governmental and business-type activities.

	As of December 31,		As of June 30,		
	2005	2004	2005	2004	2003
	(unaudited)				
Assets:					
Cash and due from banks	$ 46,551	$ 18,525,440	$ 42,535,591	$ 44,115,055	$ 25,969,477
Federal funds sold and securities purchased under agreements to resell	1,137,500,000	456,545,000	1,411,000,000	843,927,000	1,083,400,000
Deposits placed with banks	203,889,898	19,975,660	340,000,000	296,925,112	380,863,579
Investments and investment contracts	577,176,343	706,263,285	940,308,261	1,996,709,996	2,385,617,510
Loans receivable, net	6,166,360,797	5,226,963,627	5,648,911,704	4,176,438,140	2,601,193,779
Interest and other receivables	206,712,961	74,904,662	142,073,127	136,800,540	112,261,026
Due from federal government	-	-	-	15,595,228	10,601,179
Due from Puerto Rico Department of Housing	15,129,365	12,351,809	13,049,826	16,161,530	-
Due from Commonwealth of Puerto Rico	-	-	-	-	6,216,598
Due from municipalities of Puerto Rico	-	-	-	-	-
Restricted Assets:					
Cash	26,556,079	11,982,745	28,461,592	12,542,742	26,266,285
Securities purchased under agreements to resell	48,000,000	180,000,000	240,000,000	160,000,000	150,000,000
Deposits placed with banks	59,559,056	40,468,533	14,703,141	16,827,057	32,165,317
Due from federal government	17,292,543	12,280,788	20,450,310	-	-
Investments and investment contracts	1,818,042,150	1,499,465,014	1,375,860,915	1,279,645,366	1,844,633,939
Loans receivable, net	15,495,836	16,217,454	16,904,279	27,444,064	35,070,435
Interest and other receivables	14,278,473	14,388,581	5,991,612	-	-
Real estate available for sale	4,867,408	3,675,132	2,134,883	-	-
Other assets	6,569,575	11,186,842	7,025,162	-	-
Real estate available for sale	20,892,791	46,209,989	23,558,344	51,529,433	28,525,353
Capital assets	30,310,497	25,680,451	25,277,181	15,203,681	14,816,590
Other assets	49,066,491	108,826,296	67,879,837	132,849,455	129,372,782
Total assets	$ 10,417,746,814	$8,485,911,308	10,366,125,765	9,222,714,399	8,866,973,849
Liabilities:					
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:					
Demand	1,597,079,944	1,522,037,404	1,674,501,051	1,703,531,893	1,617,667,369
Certificates of deposit	3,252,858,768	1,942,716,988	3,198,159,133	2,109,361,891	1,918,890,138
Securities sold under agreements to repurchase	562,673,000		199,034,000	-	40,017,333
Commercial paper	1,129,235,939	987,669,799	1,191,202,415	918,409,931	761,166,587
Certificates of indebtedness	253,257,110	256,370,508	261,055,703	251,798,513	242,984,210
Notes payable, due within one year	-		17,636,039	-	102,436
Accrued interest payable	27,038,600	9,276,883	20,474,073	11,765,792	12,015,831
Due to Commonwealth of Puerto Rico	5,005,991	61,114	-	8,397,314	6,924,271
Accounts payable and accrued liabilities	44,617,227	71,749,994	113,244,346	104,202,511	141,492,272
Allowance for losses on guarantees and letters of credit	6,269,360	8,049,150	6,269,360	8,049,150	31,338,585
Bonds payable due in more than one year	267,000,000	267,000,000	267,000,000	267,000,000	274,756,154
Notes payable due in more than one year	10,753,914	10,016,924	10,243,583	10,339,331	9,926,924
Liabilities payable from restricted assets:					
Securities sold under agreements to repurchase	48,000,000	180,000,000	240,000,000	160,000,000	150,000,000
Accrued interest payable	4,016,388	4,435,002	3,818,315	-	-
Accrued liabilities	16,611,243	8,216,520	6,341,821	2,084,612	6,998,899
Bonds payable:					
Due in one year	53,924,899	57,677,670	90,594,868	102,513,087	84,389,645
Due in more than one year	1,080,759,755	1,201,195,180	1,104,388,002	1,249,123,021	1,412,524,045
Total liabilities	8,359,102,138	6,526,473,136	8,403,962,709	6,906,577,046	6,711,194,699
Net assets (deficit):					
Invested in capital assets	30,310,497	25,680,451	25,277,181	15,203,681	14,816,590
Restricted for:					
Debt service	47,287,994	60,774,667	53,373,737	57,405,742	56,920,167
Affordable housing programs	239,257,281	308,722,221	272,650,484	304,553,783	353,003,027
Mortgage loan insurance	42,113,128	39,491,958	40,383,280	35,675,728	23,352,153
Unrestricted assets (deficit)	1,699,675,776	1,524,768,875	1,570,478,374	1,903,298,419	1,707,687,213
Total net assets	$ 2,058,644,676	$ 1,959,438,172	$ 1,962,163,056	$2,316,137,353	$2,155,799,150

As of December 31, 2005, the Bank (including its subsidiaries) had total assets of $10.42 billion, compared to total assets of $10.37 billion as of June 30, 2005. This increase in total assets was due mainly to increases of approximately $516 million and $79 million in loan receivables and investments and investment contracts, respectively. These increases were offset by decreases in federal funds sold, securities purchased under agreement to resell, and deposits placed with banks of $273.5 million, $192 million and $91.3 million, respectively. The increase in loans was a result of additional funds available due to a reduction in the combined balance of federal funds and securities purchased under agreements to resell, and deposits placed with banks along with a net increase in total deposits. Also, total liabilities as of December 31, 2005 slightly decreased by $44.9 million to $8.4 billion as compared to June 30, 2005. This decrease was mainly due to decreases of $17.1 million in notes payable, $77.4 million in demand deposits, $62 million in commercial paper and $60.3 million in bonds payable. These decreases were offset by a $171.6 million increase in securities sold under agreements to repurchase.

Schedule of Balance Sheet Information – Government Development Bank Operating Fund

Set forth below is the Schedule of Balance Sheet Information of Government Development Bank as of June 30, 2005, 2004 and 2003, and as of December 31, 2005 and 2004, without including its subsidiaries. The information for fiscal years 2005, 2004 and 2003 is derived from the column titled "GDB Operating Fund" included in the balance sheet for the Enterprise Funds set forth in Government Development Bank's audited consolidated financial statements. The information as of December 31, 2005 and 2004 was derived from the Bank's unaudited financial statements.

	As of December 31,		As of June 30,		
	2005	2004	2005	2004	2003
	(unaudited)				
Assets:					
Current assets:					
Cash and due from banks	$ 46,551	$ 14,359,528	$ 40,524,230	$43,663,643	$ 25,500,459
Federal funds sold and securities purchased under agreements to resell	1,137,500,000	475,255,752	1,411,000,000	888,002,703	1,138,731,324
Deposits placed with banks	240,000,000		340,000,000	270,000,000	360,000,000
Investments and investment contracts	238,189,388	174,466,810	337,759,611	895,235,450	1,957,096,055
Loans receivable–net	1,495,390,905	1,964,638,146	1,412,365,799	1,767,667,512	919,194,913
Accrued interest receivable	216,229,899	83,095,162	141,932,192	129,157,981	103,052,262
Other current receivables	28,138,055	94,711,590	43,284,255	94,861,853	91,822,600
Other current assets	1,066,612	287,377	78,108	44,126	31,299
Due from governmental funds	118,660,303	108,606,009	101,593,738	111,199,804	196,900,166
Restricted:					
Investments and investment contracts	60,616,568	-	-	-	-
Accrued interest receivable	-	-	891,063	-	-
Total current assets	3,535,838,281	2,915,420,382	3,829,428,996	4,199,833,072	4,792,329,078
Noncurrent assets:					
Restricted:					
Investments and investment contracts	534,936,412	65,600,000	224,538,463	64,980,406	70,850,000
Investments and investment contracts	410,063,894	684,364,490	515,308,703	949,897,061	481,110,554
Loans receivable–net	4,524,344,627	3,114,486,175	4,103,105,758	2,210,031,803	1,438,359,354
Real estate available for sale	21,753,932	21,753,932	21,753,932	21,753,932	21,753,932
Capital assets	24,715,202	21,446,792	24,656,070	14,301,772	14,009,643
Other assets	4,852,285	5,440,337	5,453,964	9,744,189	5,553,085
Total noncurrent assets	5,520,666,352	3,913,091,726	4,894,816,890	3,270,709,163	2,031,636,568
Total assets	$ 9,056,504,633	$6,828,512,100	$8,724,245,886	$7,470,542,235	$6,823,965,646
Liabilities:					
Current liabilities:					
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:					
Demand	1,622,474,493	1,651,275,046	$1,719,760,694	1,769,116,568	1,694,086,109
Certificates of deposit	3,563,417,175	1,985,705,584	3,536,395,125	2,136,934,315	2,007,128,609
Certificates of indebtedness	240,757,110	4,571,995	213,671,703	-	-
Securities sold under agreements to repurchase	562,673,000	-	99,034,000	-	40,017,333
Commercial paper	1,129,235,939	987,669,799	1,191,202,415	918,409,931	761,166,587
Accrued interest payable	36,458,992	17,965,117	27,928,908	15,144,158	12,305,725
Accounts payable and accrued liabilities	21,738,423	46,965,971	41,077,504	56,747,708	81,620,842
Due to Commonwealth of Puerto Rico	4,999,998	-	-	8,347,184	6,894,807
Total current liabilities payable from unrestricted assets	7,182,755,130	4,695,153,514	6,829,070,349	4,904,699,864	4,603,220,012
Total current liabilities	7,182,755,130	4,695,153,514	6,829,070,349	4,904,699,864	4,603,220,012
Noncurrent liabilities:					
Certificates of deposits, principally from the Commonwealth of Puerto Rico and its public entities	317,813,068	444,958,479	259,830,318	444,958,479	242,980,846
Certificates of indebtedness	12,500,000	251,798,513	47,384,000	251,798,513	242,984,210
Securities sold under agreements to repurchase	-	-	100,000,000	-	-
Allowance for losses on guarantees and letters of credit	1,000,000	1,000,000	1,000,000	1,000,000	3,048,465
Accrued liabilities	-	-	-	-	587,500
Bonds payable	267,000,000	267,000,000	267,000,000	267,000,000	267,000,000
Total noncurrent liabilities	597,313,068	963,756,992	675,214,318	964,756,992	756,601,021
Total liabilities	7,780,068,198	5,658,910,506	7,504,284,667	5,869,456,856	5,359,821,033
Net assets:					
Invested in capital assets	24,715,202	21,446,792	24,656,070	14,301,772	14,009,643
Unrestricted	1,251,721,233	1,148,154,802	1,195,305,149	1,586,783,607	1,450,134,970
Total net assets	1,276,436,435	1,169,601,594	1,219,961,219	1,601,085,379	1,464,144,613
Total liabilities and net assets	$ 9,056,504,633	$ 6,828,512,100	$8,724,245,886	$7,470,542,235	$6,823,965,646

Consolidated Schedule of Revenues, Expenses and Change in Net Assets – Enterprise Fund

Set forth below is the consolidated Schedule of Revenues, Expenses and Change in Net Assets – Enterprise Fund for Government Development Bank and its subsidiaries for each of the fiscal years ended June 30, 2005, 2004 and 2003, which was derived from the Bank's audited financial statements, and for the six month period ended December 31, 2005 and 2004, which was derived from the Bank's unaudited financial statements. The consolidated Schedule of Revenues, Expenses and Change in Net Assets for the Enterprise Funds provides in more detail the information provided in the Statement of Activities (which is included in the basic financial statements attached hereto as *Appendix I*) with respect to the business-type activities of Government Development Bank and its subsidiaries.

The information for the fiscal year ended June 30, 2005 and the six month period ended December 31, 2005 excludes the revenues and expenses related to governmental-type activities of the housing assistance programs and debt service funds administered by Housing Finance Authority. For the fiscal year ended June 30, 2005, these governmental-type activities generated $280.7 million in revenues (of which $265.2 million are from operating grants and contributions and $15.5 million are from charges for services) and $275.7 million in expenses. These revenues and expenses from governmental activities, together with net transfers of $16 million, account for a decrease in net assets from governmental activities of $11 million for fiscal year 2005. For the six month period ended December 31, 2005, these governmental-type activities generated $107.3 million in revenues (of which $100.7 million are from operating grants and contributions and $6.6 million are from charges for services) and $85.9 million in expenses. These revenues and expenses from governmental activities, together with net transfers of $16.8 million, account for an increase in net assets from governmental activities of $38.6 million for the six month period ended December 31, 2005.

As of December 31, 2005, the Bank's Enterprise Fund had an increase in change in net assets of $466.6 million when compared to December 31, 2004. The increase in change in net assets from December 31, 2004 to December 31, 2005 is mostly attributable to the Bank's $500 million contribution to the Special Communities Irrevocable Trust Fund made in December 2004. During the six month period ended December 31, 2005, the Bank transferred $22.4 million from the Enterprise Fund to fund the subsidy programs enacted by Act No. 4 of March 29, 2001, also known as "La Llave Para Tu Hogar." This transfer, however, had no effect on the change in net assets at the government-wide level.

As of December 31, 2005, net interest income, the difference between interest income and interest expense, decreased approximately $10.2 million when compared to December 31, 2004. During the same period, interest expense increased approximately $87.8 million, or 86.5%. The decrease in net interest income is mainly attributable to the increase in interest expense associated with the higher volume of deposits (interest expense on deposits increased $65.4 million), and to increases in the overnight federal funds rate.

As required by Act No. 271 of November 21, 2002, in December 2004, Government Development Bank made a special capital contribution of $500 million to the Special Communities Irrevocable Trust. Considering this capital contribution, Government Development Bank's net assets decreased by $343 million for the fiscal year ended June 30, 2005. Excluding the capital contribution to the Special Communities Irrevocable Trust, Government Development Bank's net assets would have increased by $157 million for this period, to $2.46 billion.

	For the six month period ended December 31, 2005	2004	For the year ended June 30, 2005	2004	2003
	(unaudited)				
Operating revenues:					
Investment income					
Interest income on federal funds sold and securities purchased under agreements to resell	$ 15,760,081	$ 6,512,037	$ 17,852,688	$ 12,121,445	$ 17,530,737
Interest income on deposits placed with banks	13,707,923	9,784,529	22,030,016	15,792,596	15,045,991
Interest and dividend income on investment and investment contracts	63,087,742	59,922,203	111,984,766	123,693,709	149,029,742
Net increase (decrease) in fair value of investments	7,985,741	3,777,108	4,417,341	-	-
Total investment income	100,541,487	79,995,877	156,284,811	151,607,750	181,606,470
Loans receivable:					
Public sector	162,922,935	105,813,817	226,758,041	193,624,057	113,572,935
Private sector	11,404,016	11,464,573	23,561,155	21,483,655	17,976,134
Total interest income on loans	174,326,951	117,278,390	250,319,196	215,107,712	131,549,069
Total investment income and interest on loans	274,868,438	197,274,267	406,604,007	366,715,462	313,155,539
Noninterest income:					
Changes in fair value of investments	-	-	-	(12,320,180)	43,550,673
Fiscal agency fees	6,505,310	2,389,494	4,903,658	10,560,244	7,925,837
Commitment, guarantee, services, and administrative fees	2,996,679	4,676,981	16,158,787	11,825,674	13,748,641
Mortgage insurance premiums	1,575,337	2,465,326	2,617,379	2,540,541	2,120,872
Servicing and contract administration fees, net	4,818,813	3,834,650	-	7,491,833	8,735,966
Net gain from sale of foreclosed real estate available for sale	22,031	1,405,500	3,729,589	4,215,305	2,217,869
Gain on sale of loans	-	-	7,139,753	-	-
Payment from Commonwealth of Puerto Rico	-	-	-	-	140,214
Federal assistance programs	-	-	-	113,743,876	112,199,144
Other income	7,805,981	5,607,786	9,655,064	18,509,220	42,399,438
Total noninterest income	23,724,151	20,379,737	44,204,230	156,566,513	233,038,654
Total operating revenues	298,592,589	217,654,004	450,808,237	523,281,975	546,194,193
Operating expenses:					
Provision for loan losses	-	-	8,154,383	2,423,740	1,275,000
Interest expense:					
Deposits	106,386,983	40,984,384	113,275,539	60,269,871	80,774,107
Securities sold under agreements to repurchase	8,714,261	1,898,458	3,831,637	9,757,200	9,877,690
Commercial paper	19,758,289	5,996,121	18,954,948	3,647,839	4,364,739
Certificates of indebtedness	5,772,061	5,144,950	10,669,426	8,467,117	5,558,637
Bonds payable	48,688,786	47,468,264	97,843,359	90,372,457	94,327,789
Total interest expense	189,320,380	101,492,177	244,574,909	172,514,484	194,902,962
Non-interest expenses:					
Salaries and fringe benefits	17,989,326	18,066,701	34,760,214	33,244,389	30,305,912
Depreciation and amortization	3,132,067	3,136,238	2,997,129	2,628,409	3,073,928
Occupancy and equipment costs	1,665,493	2,712,786	4,019,767	3,728,093	4,185,650
Legal and professional fees	898,548	361,101	7,278,043	8,115,443	8,066,433
Office and administrative	178,386	159,605	606,727	1,092,739	1,162,230
Subsidy and trustee fees	-	-	430,510	422,233	2,349,273
Provision (credit) for losses on guarantees and letters of credit	-	-	(1,779,790)	-	14,363,575
Federal assistance programs	-	-	-	113,743,876	112,199,144
Other	1,649,163	4,245,841	6,267,071	16,425,562	23,555,062
Total noninterest expenses	25,512,983	28,682,272	54,579,671	179,400,744	199,261,207
Total operating expenses	214,833,363	130,174,449	307,308,963	354,338,968	395,439,169
Operating income	83,759,226	87,479,555	143,499,274	168,943,007	150,755,024
Nonoperating Expenses:					
Contributions to Special Communities Irrevocable Trust Fund	-	(500,000,000)	(500,000,000)	-	-
Contributions to Cooperative Development Investment Fund and other	(8,871,530)	(2,631,903)	(2,501,195)	-	-
Total nonoperating expenses	(8,871,530)	502,631,903	(502,501,195)	-	-
Contributions to others	-	-	-	(22,672,151)	(19,185,150)
Special item - net loss on early extinguishment of bonds	-	-	-	(18,382)	-
Contributions to Special Communities Trust	-	-	-	(3,340,319)	-
INCOME BEFORE TRANSFERS	74,887,696	(415,152,348)	(359,001,921)	-	-
Transfer in	5,588,916	9,815,970	22,074,908	21,354,775	56,554,866
Transfer out	(22,398,706)	(3,171,097)	(6,060,888)	(5,071,701)	(11,544,394)
Change in net assets	58,077,906	(408,507,475)	(342,987,901)	159,195,229	176,580,346
Net assets, beginning of year	1,955,840,585	2,298,828,486	2,298,828,486	2,139,633,257	1,963,052,911
Net assets, end of year	$2,013,918,491	$1,890,321,011	$1,955,840,585	$2,298,828,486	$2,139,633,257

Schedule of Revenues, Expenses and Change in Net Assets – Government Development Bank Operating Fund

Set forth below is the Schedule of Revenues, Expenses and Change in Net Assets – Government Development Bank Operating Fund for each of the fiscal years ended June 30, 2005, 2004 and 2003, and for the six month period ended December 31, 2005 and 2004, which was derived from the Bank's unaudited financial statements, without including its subsidiaries. The Schedule of Revenues, Expenses and Change in Net Assets for Government Development Bank's Operating Fund provides in more detail information with respect to the business-type activities of Government Development Bank as a stand alone entity (without including its subsidiaries). The information set forth in the table below for fiscal years 2005, 2004 and 2003 is derived from the column titled "GDB Operating Fund" included in the Statement of Revenues, Expenses and Change in Net Assets – Enterprise Funds set forth in Government Development Bank's fiscal year 2005, 2004 and 2003 audited consolidated financial statements.

	For the six month period ended December 31, 2005	2004	For the year ended June 30, 2005	2004	2003
	(unaudited)				
OPERATING REVENUES					
Investment income:					
Interest income on federal funds sold and securities purchased under agreements to resell	$13,963,991	$ 5,113,415	$14,329,227	$10,062,667	$13,863,033
Interest income on deposits placed with banks	1,106,296	582,532	1,852,010	2,112,984	3,250,461
Interest and dividend income on investments and investment contracts	27,730,464	21,741,089	43,923,733	48,755,515	73,124,679
Net increase (decrease) in fair value of investments(1)	2,345,170	4,052,570	8,547,378	(1,284,981)	15,267,657
Total investment income	45,145,921	31,489,606	68,652,348	60,931,166	90,238,173
Loans receivable:					
Public sector	162,922,935	105,813,817	226,758,041	193,624,057	113,572,935
Private sector	1,067,206	991,670	2,227,233	1,127,681	664,253
Total interest income on loans	163,990,141	106,805,487	228,985,274	194,751,738	114,237,188
Total investment income and interest income on loans	209,136,062	138,295,093	297,637,622	255,682,904	204,475,361
Non-interest income:					
Fiscal agency fees	6,364,556	2,331,868	4,199,269	8,363,836	7,925,837
Commitment, guarantee, service, and administrative fees	845,291	929,622	3,374,624	2,565,448	2,362,599
Servicing and contract administration fees, net	1,104,774	797,463	-	1,785,912	2,333,859
Other income	6,161,213	647,223	1,443,952	4,950,939	37,978,367
Total non-interest income	14,475,834	4,706,176	9,017,845	16,381,154	65,868,319
Total operating revenues	223,611,896	143,001,269	306,655,467	272,064,058	270,343,680
OPERATING EXPENSES					
Provision (credit) for loan losses	-	-	(1,868,258)	661,164	-
Interest expense:					
Deposits	104,440,545	40,950,660	113,275,539	60,222,089	80,769,369
Securities sold under agreements to repurchase	6,931,903	22,996	174,436	180,988	8,126
Commercial paper	19,758,289	5,996,121	18,954,948	8,467,117	5,558,637
Certificates of indebtedness	5,772,061	5,144,950	10,669,426	9,757,200	9,877,690
Bonds and notes payable	4,050,889	1,957,811	4,930,106	(1,107,552)	8,809,901
Total interest expense	140,953,687	54,072,538	148,004,455	77,519,842	105,023,723
Non-interest expenses:					
Salaries and fringe benefits	12,635,066	12,649,043	25,220,939	23,042,273	22,186,969
Depreciation and amortization	-	-	2,672,479	2,364,672	2,800,137
Occupancy and equipment costs	2,638,373	2,562,302	2,960,012	2,769,566	3,352,593
Legal and professional fees	637,544	1,132,042	2,946,825	4,336,409	5,255,586
Office and administrative	343,244	316,526	603,231	739,314	737,504
Subsidy and trustee fees	-	-	-	5,927	39,983
Other	1,059,736	1,120,700	4,738,749	2,172,107	22,720,116
Total non-interest expenses	17,313,963	17,780,613	39,142,235	35,430,268	57,092,888
Total operating expenses	158,267,650	71,853,151	185,278,432	113,611,274	162,116,611
Operating income	65,344,246	71,148,118	121,377,035	158,452,784	108,227,069
NONOPERATING EXPENSES					
Contributions to Special Communities Trust	-	(500,000,000)	(500,000,000)	-	-
Contributions to Cooperative Development Investment Fund and Other	(8,869,030)	(2,631,903)	(2,501,195)	-	-
Total nonoperating expenses	(8,869,030)	(502,631,903)	(502,501,195)	-	-
Contributions to others	-	-	-	(22,672,151)	(19,185,150)
Contributions to Special Communities Irrevocable Trust Fund	-	-	-	(3,340,319)	-
INCOME BEFORE TRANSFERS	56,475,216	(431,483,785)	(381,124,160)	-	-
Transfer in	-	-	-	4,748,063	-
Transfer out	-	-	-	(247,611)	(300,000)
Change in net assets	56,475,216	(431,483,785)	(381,124,160)	136,940,766	88,741,919
Net assets–beginning of year	1,219,961,219	1,601,085,379	1,601,085,379	1,464,144,613	1,375,402,694
Net assets–end of year	$1,276,436,435	$1,169,601,594	$1,219,961,219	$1,601,085,379	$1,464,144,613

(1) Amounts for fiscal years 2004 and 2003 have been included for the sake of consistency.

Capitalization

The following table sets forth the notes, bonds and net assets of Government Development Bank (not including its subsidiaries) as of December 31, 2005 and as adjusted to give effect to the issuance of the Series A Notes and the Series B Notes.

	December 31, 2005 (unaudited)	As Adjusted for the Issuance of the Series A Notes and the Series B Notes
Notes and Bonds		
Adjustable Refunding Bonds Due December 1, 2015	$ 267,000,000	$ 267,000,000
Commercial paper program	1,129,235,939	1,129,235,939*
Series A Notes	-	885,000,000
Sub-Total	1,396,235,939	2,281,235,939
Notes offered hereby	-	740,000,000
Total Notes and Bonds	1,396,235,939	3,021,235,939
Net Assets		
Invested in capital assets	24,715,202	24,715,202
Unrestricted	1,251,721,233	1,251,721,233
Total net assets	1,276,436,435	1,276,436,435
Total Notes, Bonds and Net assets	$2,672,672,374	$4,297,672,374

* Approximately $370.7 million will be paid off with the proceeds of the Series B Notes.

Interest Rate Spread

The following table sets forth, for each of the three fiscal years in the period ended June 30, 2005, and for the six month period ended December 31, 2005 and 2004, the average interest rate earned by Government Development Bank (excluding its subsidiaries) on its interest-earning assets and the average interest rate paid by Government Development Bank (excluding its subsidiaries) for its interest-bearing liabilities and the corresponding spread.

	For the six month period ended December 31,		For the year ended June 30,		
	2005	**2004**	**2005**	**2004**	**2003**
Average interest rate earned	4.94%	4.09%	3.87%	3.34%	3.09%
Average interest rate paid	3.91%	2.26%	2.52%	1.96%	1.78%
Spread	1.03%	1.83%	1.35%	1.38%	1.31%

Liquidity and Sources of Funding

As of June 30, 2005, approximately $2.6 billion, or 29.9%, of Government Development Bank's assets (excluding its subsidiaries) consisted of cash and due from banks, money market instruments and investment securities classified among the three highest rating categories. Approximately $1.9 billion, or 65.4%, of the investment securities portfolio matured in 30 days or less. Of the $2.8 billion in the investment securities portfolio, approximately $224.5 million was pledged to secure borrowings of Government Development Bank.

As of December 31, 2005, approximately $2.3 billion, or 25.4%, of Government Development Bank's assets (excluding its subsidiaries) consisted of cash and due from banks, money market instruments and investment securities classified among the three highest rating categories. Approximately $1.4 billion, or 52.6%, of the investment securities portfolio matured in 30 days or less. Of the $2.6 billion in the investment securities portfolio, approximately $595.6 million was pledged to secure borrowings of Government Development Bank.

Government Development Bank has intensified its efforts to increase and diversify its funding sources. As part of this initiative, Government Development Bank has reduced dependency on government deposits by increasing private deposits (including certificates of indebtedness) from $487 million as of June 30, 2004, to $860 million as of June 30, 2005 and $1.8 billion as of December 31, 2005. Total deposits and certificates of indebtedness increased from $4.3 billion to $5.8 billion from June 30, 2004 to June 30, 2005. As of December 31, 2005, total deposits and certificates of indebtedness remained at approximately $5.8 billion. The following table sets forth a breakdown of Government Development Bank's (not including subsidiaries) total funding by source.

	As of December 31,				As of June 30,					
	2005		2004		2005		2004		2003	
	Amount	%	Amount	%	Amount (in millions)	%	Amount	%	Amount	%
Funding Source										
Public Funds:										
Demand Deposit	$1,622	21.03%	1,651	29.52%	$1,720	23.14%	$1,769	30.56%	$1,694	32.23%
Certificates of Deposit	2,342	30.35%	2,116	37.84%	3,197	43.01%	2,347	40.55%	2,198	41.82%
Commercial Paper	1,129	14.64%	988	17.66%	1,191	16.02%	918	15.87%	761	14.48%
Private Deposits	1,793	23.23%	571	10.21%	860	11.57%	487	8.41%	296	5.63%
Bonds	267	3.46%	267	4.77%	267	3.59%	267	4.61%	267	5.08%
Repurchase Agreements	563	7.29%	-	0.00%	199	2.67%	-	0.00%	40	0.76%
Total	$7,716	100.00%	$5,593	100.00%	$7,434	100.00%	$5,788	100.00%	$5,256	100.00%

During the first half of fiscal year 2006, Government Development Bank improved its liquidity as a result of the repayment of various lines of credit in an aggregate principal amount of approximately $1.8 billion from the proceeds of bond issues by the Highways and Transportation Authority, the Municipal Finance Agency and the Commonwealth. During the second half of fiscal year 2006, the Bank has further improved its liquidity as a result of the issuance of its $885,000,000 Senior Notes, 2006 Series A and the repayment by the Convention Center District Authority of approximately $372 million of its line of credit with the Bank from proceeds of a bond issue. The Bank expects to use the proceeds of its Senior Notes, 2006 Series A to replace higher cost funding sources and lend funds to the Commonwealth and its public corporations. The Bank expects to improve further its liquidity as a result of the repayment of a line of credit in connection with the Jose Miguel Agrelot Coliseum from the proceeds of a bond issue, the sale to private financial institutions of various loans in its public sector loan portfolio, the repayment of a Commonwealth line of credit from the proceeds of a general obligation bond issue, and the replacement of outstanding commercial paper as a funding source for medium to long term loans. Additional liquidity is provided by Government Development Bank's current commercial paper program and by lines of credit that Government Development Bank has arranged with local and foreign banks totaling $1.4 billion.

Government Development Bank's total level of public sector loans as of December 31, 2005 represented an increase of $541.7 million as compared to the level of public sector loans as of June 30, 2005. However, Government Development Bank expects that, by June 30, 2006, it will have reduced the total level of public sector loans from the June 30, 2005 level by approximately $100 million (assuming the Bank disburses a loan of $638 million to finance the Commonwealth's fiscal year 2006 budget deficit). See "Possible Impact of the Commonwealth's Fiscal Imbalance on the Finances of Government Development Bank" below.

Although Government Development Bank expects to have improved its liquidity by the end of fiscal year 2006 as a result of the measures described above, its ability to raise funds from the issuance of new debt obligations may be limited by any further downgrade to the Bank's credit rating, which may result from, among others, a downgrade of the Commonwealth's credit rating. Government Development Bank, however, believes that it would be able to replace funds generated by the issuance of debt obligations with alternate sources of funds, such as repurchase agreements and incremental deposits of government funds currently held in private banks. See "Possible Impact of the Commonwealth's Fiscal Imbalance on the Finances of Government Development Bank" below.

Special Capital and Income Contributions by Government Development Bank

Act No. 271 of November 21, 2002 required Government Development Bank to make a special capital contribution to the Special Communities Perpetual Trust of $500 million and to provide the Trust a $500 million non-revolving line of credit. In December 2004, Government Development Bank transferred to the Special Communities Irrevocable Trust the required $500 million capital contribution and an additional $270.7 million, which represented the remaining undisbursed balance of the $500 million line of credit. The amounts transferred to the Special Communities Irrevocable Trust were deposited in two investment accounts held by Government Development Bank for the benefit of the Special Communities Perpetual Trust. As of December 31, 2005, the Special Communities Perpetual Trust had repaid $74.9 million of its line of credit and had an outstanding balance of $425.1 million. The line of credit is payable from legislative appropriations.

Act No. 82 of June 16, 2002 ("Act No. 82") amended Government Development Bank's Charter to authorize Government Development Bank to transfer annually to the General Fund, beginning with fiscal year 2001, up to 10% of its audited net income or $10,000,000, whichever is greater. Government Development Bank is not required by Act No. 82 to transfer any funds. Government Development Bank made payments to the General Fund of $11.6 million for fiscal year 2003 and $18.4 million for fiscal year 2004. Government Development Bank did not make a payment to the General Fund under Act No. 82 for fiscal year 2005. The Bank expects it will not make a payment to the General Fund under Act No. 82 for fiscal year 2006.

Possible Impact of the Commonwealth's Fiscal Imbalance on the Finances of Government Development Bank

As discussed above, one of Government Development Bank's principal functions is to provide financing to the Commonwealth and its instrumentalities. Accordingly, Government Development Bank's loan portfolio includes loans to various departments and agencies of the central government, to various public corporations, and to municipalities. Loans to the central government and its agencies typically include a working capital line of credit payable from short-term tax and revenue anticipation notes issued by the Commonwealth, interim financing of capital improvements payable from Commonwealth general obligation bonds, and in recent years loans to finance the central government's budget deficit, which loans are payable from uncollected taxes and from annual appropriations made by the Legislative Assembly. It is primarily the loans to the central government payable from uncollected taxes and from annual appropriations that are most affected by the Commonwealth's current fiscal imbalance, and which, therefore, have a greater potential of affecting Government Development Bank's financial condition and liquidity.

The amount of loans to finance the central government's budget deficit which are payable from uncollected taxes and legislative appropriations has increased during the last five fiscal years. During fiscal years 2003, 2004 and 2005, Government Development Bank made loans to the central government in the principal amounts of $250 million, $233 million and $550 million, respectively, to cover the central government's budget deficit. As of December 31, 2005, the outstanding principal amount of Government Development Bank loans made to finance the central government's budget deficit which are payable from uncollected taxes and legislative appropriations was $1.02 billion and constituted 16.7% of the outstanding principal amount of Government Development Bank's public sector loans and 9.8% of the Bank's consolidated assets. This amount does not include $319.7 million that remained outstanding after the Commonwealth's repayment of Government Development Bank lines of credit disbursed in connection with the Commonwealth's issuance of tax and revenue anticipation notes and the loan of up to $741 million to finance a portion of the Commonwealth's fiscal year 2006 budget deficit. Government Development Bank expects the Commonwealth to repay the outstanding balance of $319.7 million on or prior to June 30, 2006.

The Legislature generally has approved the appropriations required to pay the annual debt service of those public sector loans that are payable from uncollected taxes and legislative appropriations. Government Development Bank has never suffered a loss on any of its public sector loans, and does not expect to suffer any such loss in the future. In some cases, however, Government Development Bank has placed certain public sector loans on non-accrual status. Also, payments of debt service on some of these loans has been deferred from time to time and may be deferred in the future during periods of budgetary constraints. Such actions would reduce the Bank's operating income. For fiscal year 2006, debt service payments of approximately $510.7 million on certain loans payable from uncollected taxes and legislative appropriations were postponed. Also, in fiscal year 2006, the Commonwealth financed a portion of the debt service payments on its debt due during such fiscal year with moneys drawn under a $384 million line of credit with the Bank because the appropriations included in the current fiscal year 2006 budget were insufficient to cover all debt service payments due during the fiscal year on the Commonwealth's debt. The Commonwealth expects eventually to finance the Bank's $384 million line of credit through a bond issuance.

As mentioned above, during fiscal years 2003, 2004 and 2005, the Commonwealth's recurring expenditures exceeded its recurring revenues. These shortfalls were covered with loans from Government Development Bank and other non-recurring revenues. Although the Commonwealth intends to implement various revenue-enhancing and cost-reducing measures to bring expenditures in line with revenues, and expects these measures to balance its revenues and expenses by the end of fiscal year 2009, the Commonwealth's recurring expenditures for fiscal year 2006, and possibly for fiscal year 2007, are currently anticipated to exceed its recurring revenues. These deficits would have to be covered by non-recurring sources, including additional loans from Government Development Bank. Currently, the Commonwealth estimates the budget deficit for fiscal year 2006 at $738 million. As discussed above, the Bank may provide the Commonwealth with a loan to finance a portion of the fiscal year 2006 budget deficit.

In May 2005, Moody's and S&P each announced downgrades to the Commonwealth's general obligation debt rating, and assigned it a "negative" outlook, in part because of the fiscal imbalance mentioned above. On February 24, 2006, Moody's placed the Commonwealth's credit on its Watchlist for a possible future downgrade. Similarly, on March 22, 2006, S&P placed the Commonwealth's credit on CreditWatch with negative implications. On May 8, 2006, Moody's downgraded the Commonwealth's general obligation and appropriation bond ratings to "Baa3" from "Baa2" and to "Ba1" from "Baa3," respectively, and kept the rating on Watchlist for possible further downgrade.

The Commonwealth's access to funding through the bond market to finance its capital improvement programs and those of its instrumentalities may be adversely affected if its credit rating is further reduced. If this happens, Government Development Bank may be asked to provide financing for these capital improvement programs or for other working capital needs. The Bank is not required by law to provide such financing. Under a law enacted in 2001, the Bank is prohibited from making loans to any governmental entity for which the source of repayment consists of appropriations from the General Fund without first obtaining the approval of the Legislative Assembly, with certain limited exceptions, including if such loan is needed to cover the entities' debt service. See "General" under *Loans by Government Development Bank to the Commonwealth, its Public Corporations and Municipalities*. It is also the Bank's current policy not to provide financing to any instrumentality of the Commonwealth (other than the central government) unless the Bank is satisfied that it has the ability to repay such financing from its own revenues. The Bank, however, has provided this type of financing in the past to the Aqueduct and Sewer Authority and other government entities that have not had sufficient independent sources of revenue. Furthermore, the Bank has approved a loan to the Commonwealth of up to $741 million to finance a portion of the Commonwealth's fiscal year 2006 budget deficit. Any material increase in the amount of loans to the public sector may have an adverse effect on Government Development Bank's financial condition.

The credit rating of certain public corporations that generate their own revenues, such as the Electric Power Authority and the Highways Authority, are not entirely dependent on the Commonwealth's rating. Therefore, a further downgrade of the Commonwealth's credit rating may not affect these entities' access to the bond market.

If, notwithstanding the Bank's efforts, its level of public sector loans increases as a result of the reasons mentioned above, or if debt service payments on these loans are deferred, Government Development Bank may need to increase its borrowings or otherwise access alternate sources of funds. Government Development Bank's ability to raise additional debt in the capital markets, however, may be affected by any further downgrade of the Commonwealth's credit rating, which may result in a further downgrade of its own credit rating. Although the Bank believes that it has adequate alternate sources of funds, such as deposits of government instrumentalities currently held by private banks, no assurance can be given that the Bank would in fact be able to access these alternate sources of funds.

INVESTMENT PORTFOLIO

General

The following tables set forth Government Development Bank's (not including its subsidiaries) investment portfolio at June 30, 2005, 2004 and 2003, and as of December 31, 2005 and 2004, by instrument and maturity. As of December 31, 2005, the expected average life of Government Development Bank's investment portfolio is 2.97 years and approximately 63.95% of the investment portfolio has an average life of less than one year. The short average life of Government Development Bank's investment portfolio has allowed it to benefit from recent rate increases. At June 30, 2005, 2004, and 2003, Government Development Bank's investment portfolio was $2.8 billion, $3.1 billion, and $4.1 billion, respectively. At December 31, 2005 and December 31, 2004, Government Development Bank's investment portfolio was $2.6 billion and $1.4 billion, respectively.

The following table shows Government Development Bank's investment portfolio by type of instrument:

	As of December 31,				As of June 30,					
	2005		2004		2005		2004		2003	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
					(in millions)					
Instrument										
United States Government and Sponsored Agencies Securities	$ 617	23.54%	$ 378	24.17%	$ 476	16.82%	$ 1,343	43.77%	$ 1,875	46.78%
Money Market	1,378	52.57%	474	33.91%	1,755	62.04%	1,143	37.26%	1,499	37.40%
Non-Participating Investment Contracts	432	16.49%	423	30.23%	428	15.13%	421	13.72%	457	11.40%
Other	194	7.40%	164	11.69%	170	6.01%	161	5.25%	177	4.42%
Total	$2,621	100.00%	$1,399	100.00%	$2,829	100.00%	$3,068	100.00%	$4,008	100.00%

The following table shows Government Development Bank's investment portfolio by maturity:

	As of December 31,				As of June, 30,					
	2005		2004		2005		2004		2003	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
					(in millions)					
Maturity										
Less than one year	$ 1,676	63.95%	$ 649	46.38%	$ 2,089	73.84%	$ 1,973	64.31%	$ 3,523	87.90%
1 to 5 years	379	14.44%	403	28.83%	335	11.84%	668	21.77%	245	6.11%
Greater than 5 years	566	21.61%	347	24.79%	405	14.32%	427	13.92%	240	5.99%
Total	$2,621	100.00%	1,399	100.00%	$2,829	100.00%	$3,068	100.00%	$4,008	100.00%

Hedging and Derivatives

Government Development Bank's policy does not allow the use of derivatives for trading purposes or for off-balance sheet leveraged transactions.

Government Development Bank uses derivatives in its asset and liability management activities, which include hedging activities. The derivatives utilized are limited to interest rate swaps and caps, structured notes and indexed swaps.

The total notional amount in interest rate swaps to fix certain floating rate debt (in order to match this liability with corresponding long-term fixed rate securities) as of December 31, 2005 amounted to approximately $637 million.

LOANS BY GOVERNMENT DEVELOPMENT BANK TO THE COMMONWEALTH, ITS PUBLIC CORPORATIONS AND MUNICIPALITIES

General

The table below shows, for each of Government Development Bank's public sector borrowers whose aggregate outstanding principal amount owed to Government Development Bank exceeds $50,000,000 as of December 31, 2005 (other than municipalities), the name of the borrower, the aggregate outstanding principal amount borrowed and the source or sources of repayment:

Name of Borrower	Outstanding Principal Amount (in thousands)	Sources of Repayment
Departments and Agencies of the Commonwealth		
Agricultural Services Administration	$ 67,000	Legislative appropriations
Commonwealth of Puerto Rico – Department of the Treasury	2,208,679	Legislative appropriations; proceeds of Commonwealth general obligation bonds; and federal funds
Department of Agriculture	60,373	Legislative appropriations and proceeds of Commonwealth general obligation bonds
Department of Education	124,813	Federal grants and legislative appropriations
Department of Transportation and Public Works	84,632	Legislative appropriations and proceeds of Commonwealth general obligation bonds
Municipal Revenue Collection Center	365,218	Legislative appropriations and property taxes
Public Corporations of the Commonwealth		
Aqueduct and Sewer Authority	467,165	Operating revenues; legislative appropriations and proceeds of bond issues
Convention Center District Authority	500,868†	Proceeds of bond issue; legislative appropriations and proceeds of Commonwealth general obligation bonds
Electric Power Authority	169,643	Operating revenues; proceeds of bond issue; and legislative appropriations
Housing Finance Authority	95,575	Legislative appropriations; proceeds of Commonwealth general obligation bonds; FEMA; and funds from the sale of housing units
Ports Authority	301,560	Operating revenues and proceeds of bond issues
Solid Waste Authority	74,861	Legislative appropriations and proceeds of Commonwealth general obligation bonds
Special Communities Perpetual Trust	425,107	Legislative appropriations and proceeds of Commonwealth general obligation bonds
Tourism Development Fund	242,235	Proceed of the sales of Cayo Largo; operating revenues; proceeds of bond issues; and legislative appropriations
University of Puerto Rico	63,584	Operating revenues; proceeds of bond issues; and legislative appropriations
Subtotal	5,251,313	
Other Loans‡	436,560	
Total	5,687,873	

† Approximately $372 million was repaid on March 24, 2006, from the proceeds of a bond issue in the aggregate principal amount of $468.8 million.
‡ Reflects the aggregate principal amount of all other loans outstanding to departments and agencies of the Commonwealth and its public corporations.

The table below shows the principal amounts owed to Government Development Bank from public sector loans by source of repayment:

Source of Repayment	Outstanding Principal Amount as of December 31, 2005
	(in millions)
Legislative Appropriations	$2,294
Proceeds of Commonwealth General Obligation Bonds	1,329
Proceeds of Bond Issues (other than proceeds of Commonwealth general obligation bonds)	735
Federal Funds (including FEMA, Federal Grants and other funds received from the federal government)	272
Operating Revenues of the respective borrower (including proceeds generated through the sale of assets and/or operations)	1,058

Act No. 164 of 2001 ("Act No. 164") prohibits Government Development Bank from making loans to any governmental entity for which the source of repayment consists of appropriations from the General Fund without first obtaining the approval of the Legislative Assembly, except for (i) loans up to an aggregate amount of $100,000,000 as long as, among other things, Government Development Bank obtains the written approval of the Governor and the Director of OMB, (ii) loans to any financially troubled governmental entity to enable it to honor its debt obligations, and (iii) loans to the Secretary of the Treasury under legislation authorizing the Secretary to borrow funds in anticipation of tax revenues.

Under the provision of the Joint Resolution that sets forth the principles of the proposed fiscal reform, it is proposed that Act No. 164 and certain other laws that authorize the Secretary of the Treasury to borrow funds in anticipation of tax revenues be amended to require that the Secretary of the Treasury obtain the approval of the Legislative Assembly before entering into any loan (i) whose proceeds will be used to balance the Commonwealth's budget, and (ii) which would not be repaid in the then current fiscal year.

Loans to Departments and Agencies of the Commonwealth

General. The Secretary of the Treasury and other agencies of the central government of the Commonwealth may borrow monies from Government Development Bank for capital improvements and operating needs. The loans for capital improvements are payable from the proceeds of future bond issues and the loans for operating needs are payable principally from future legislative appropriations. As of December 31, 2005, the outstanding principal amount of Government Development Bank loans to the Commonwealth and other central government agencies was $3.2 billion, of which $1.02 billion was used by the Commonwealth to finance the budget deficits for fiscal years 2003, 2004 and 2005. These borrowings are payable from uncollected taxes and future legislative appropriations in 10 years or less.

The following are summary descriptions of some of the departments and agencies of the Commonwealth that have loans outstanding from Government Development Bank and the respective amounts of their outstanding indebtedness.

Agricultural Services Administration. The Agricultural Services Administration is a separate legal entity attached to the Department of Agriculture. The Administration is authorized to provide agricultural services to promote the development of farming and of agriculture in general. As of December 31, 2005, the Administration had $67 million of indebtedness outstanding with Government Development Bank, payable from Commonwealth appropriations.

Department of the Treasury. The Commonwealth, through the Department of the Treasury, is authorized to borrow funds from Government Development Bank. During fiscal years 2003, 2004 and 2005, Government Development Bank provided loans to the Secretary of the Treasury in order to cover the Commonwealth's budget deficits for those fiscal years. These loans were in the principal amount of $250 million, $233 million and $550 million, respectively. Government Development Bank expects to provide a loan to the Secretary of the Treasury to finance most of the remaining portion of the Commonwealth's budget deficit for fiscal year 2006.

As of December 31, 2005, the aggregate outstanding principal amount of all loans made to the Secretary of the Treasury was $2.21 billion, which includes, among others, $1.02 billion to cover budget deficits; $195.1 million to cover debt service payments on general obligation bonds; and $319.7 million disbursed in anticipation of the issuance of Tax and Revenue Anticipation Notes. On December 29, 2005, the Commonwealth repaid Government Development Bank a portion of the amounts disbursed in anticipation of the Commonwealth's issuance of tax and revenue anticipation notes. A balance of approximately $319.7 million remains outstanding under this Government Development Bank line of credit. Government Development Bank expects the Commonwealth to repay this outstanding balance of $319.7 million from tax collections on or prior to June 30, 2006.

Department of Agriculture. The Department of Agriculture is engaged in providing loans to farmers and in building and leasing commercial buildings. As of December 31, 2005, outstanding indebtedness to Government Development Bank was approximately $60.4 million.

Department of Education. The Department of Education is responsible for the planning, structuring and administration of the Commonwealth's public school system, including its school facilities and curriculums. The Secretary of Education is also responsible for the implementation of fiscal controls on a system-wide and individual school basis, system-wide budget planning, and the evaluation of scholastic performance and achievement. As of December 31, 2005, outstanding indebtedness to Government Development Bank was approximately $124.8 million.

Department of Transportation and Public Works. The Department of Transportation and Public Works is responsible for all public works carried out in Puerto Rico, including all roads and highways, and all public property of the Commonwealth. As of December 31, 2005, outstanding indebtedness to Government Development Bank was approximately $84.6 million.

Municipal Revenues Collection Center. The Municipal Revenues Collection Center ("CRIM" by its Spanish acronym) was created in 1991 as a municipal entity charged with the collection, receipt and allocation of municipal property tax revenues. As of December 31, 2005, CRIM had $365.2 million in indebtedness outstanding with Government Development Bank payable from its revenues, which consist of the retention by CRIM of a small percentage of all collections of property taxes made by it on behalf of the municipalities.

Loans to Public Corporations

Government Development Bank lends funds to the public corporations of the Commonwealth for capital improvements and operating needs. The loans to public corporations for capital improvements generally are construction loans and are repaid from the proceeds of future bond issues of the respective public corporations. Such loans may, however, also be repaid from the revenues of such public corporations, from accreting certificates of deposit held by Government Development Bank, from loans provided by sources other than Government Development Bank, from federal grants, and from the sale of assets of such public corporations. The amount of outstanding loans from Government Development Bank to the public corporations fluctuates annually, depending upon the capital program needs of the public corporations, the timing and level of their capital expenditures, and their ability to gain access to the long-term capital markets. As of December 31, 2005, the principal amount of loans outstanding to public corporations was approximately $2.5 billion.

The following are summary descriptions of some of the public corporations that have loans outstanding from Government Development Bank and the respective amounts of their outstanding indebtedness.

Aqueduct and Sewer Authority. Puerto Rico Aqueduct and Sewer Authority ("PRASA") owns and operates the island's public water supply and sanitary sewer facilities systems (the "Systems"). As of December 31, 2005, PRASA had $467.2 million of loans outstanding from Government Development Bank.

PRASA needs to make a substantial investment in infrastructure and a major overhaul of its operations to maintain the viability of the Systems and to finance its expansion for new users. Funds for this investment are expected to be provided through a combination of revenues from PRASA, financing transactions, federal grants and other sources. Debt service on revenue bonds is payable from net revenues of the Systems after payment of current expenses. Due to PRASA's financial difficulties (discussed below) and its inability to access the bond market, Act No. 45 was enacted in July 1994 to provide a Commonwealth guaranty of the principal and interest payments to the bondholders of all outstanding revenue bonds issued by PRASA. In addition, Act No. 45 was amended in 2000 to extend the Commonwealth payment guaranty to all outstanding bonds issued by PRASA to the United States Department of Agriculture, Rural Development, and loans granted by the Clean Water and Drinking Water State Revolving Funds for the benefit of PRASA. In February 2004, this guaranty was extended through new legislation to include debt obligations issued until 2010. The total debt of PRASA was $1.14 billion as of December 31, 2005.

PRASA reported operational losses of $282.5 million and $343.0 million during fiscal years 2004 and 2005, respectively.

Beginning in fiscal year 2006, the Commonwealth's General Fund has ceased to provide financial assistance to PRASA. As part of its efforts to regain fiscal independence, PRASA announced substantial increases in water and wastewater service rates, to be implemented in two phases. The first phase took effect on October 10, 2005. The second phase will take effect on July 1, 2006. The new rate structure also includes changes from bi-monthly to monthly invoicing of residential customers. On September 21, 2005, the Governor of Puerto Rico and the President of Government Development Bank announced that Government Development Bank would extend PRASA a line of credit in the aggregate principal amount of $200 million to allow PRASA to implement its planned rate increases in two phases. PRASA expects to repay this line of credit from the additional revenues generated by the rate increase. On October 27, 2005, PRASA executed a loan agreement with respect to the first $100 million. In order to achieve fiscal independence, however, PRASA will have to implement various changes, such as (i) aggressive cost savings programs; and (ii) a new and aggressive enforcement policy to identify and process delinquent customers. Although PRASA will require Government Development Bank financial assistance until these measures are fully implemented, these measures are intended to allow PRASA to become financially independent in the future.

Convention Center District Authority. The Convention Center District Authority was created to own, develop, finance, plan, design, build, operate, maintain, administrate and promote a new convention center and designated private parcels located within the Convention Center District in San Juan. The convention center opened on November 17, 2005. The Authority (excluding lines of credit with respect to the José Miguel Agrelot Coliseum) currently has lines of credit with Government Development Bank totaling $415.7 million, of which $347.4 million was outstanding as of December 31, 2005.

The Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA") financed the construction of a multi-purpose coliseum in San Juan, known as the José Miguel Agrelot Coliseum, with a line of credit provided by Government Development Bank. The José Miguel Agrelot Coliseum was recently completed and transferred to the Convention Center District Authority. Pursuant to Act No. 185 of August 3, 2004, AFICA also transferred the line of credit to the Convention Center District Authority. As of December 31, 2005, this line of credit with Government Development Bank totaled $230 million, of which $153.5 million was outstanding.

The Authority's lines of credit with Government Development Bank (including lines of credit with respect to the José Miguel Agrelot Coliseum) total $645.7 million, of which $500.9 million was outstanding as of December 31, 2005. On March 24, 2006, the Authority repaid approximately $372 million of its lines of credit with the Bank from the proceeds of a bond issue in the aggregate principal amount of approximately $468.8 million. The Authority intends to issue long-term bonds within the next few months to refinance its lines of credit with the Bank in connection with the José Miguel Agrelot Coliseum.

Electric Power Authority. The Authority owns and operates the island's electric system. The capital improvement program for the five-year period ending June 30, 2010 is estimated to cost approximately $2.1 billion and will be financed primarily by borrowed funds, supplemented by internally generated funds. The Authority's bonded debt consists of Power Revenue Bonds, secured by a lien on net revenues of the electric system. As of December 31, 2005, the Authority's total debt was $5.6 billion, including $5.1 billion of bonds outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds) and $169.6 million outstanding under various Government Development Bank lines of credit.

Highways and Transportation Authority. The Authority is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of the Authority, and federal and Commonwealth grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the tax on gasoline, one-half of the proceeds of the tax on gas oil and diesel oil, all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year, highway toll revenues (which were increased approximately 43% in September 2005), and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and to payments required to be made by the Commonwealth under its guarantees of bonds and notes, to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment. As of December 31, 2005, after giving effect to an $800 million bond issuance used to repay the Authority's capital improvement line of credit with Government Development Bank and to fund the Authority's capital improvement plan, the Authority's total debt was $6.5 billion. This excludes certain non-recourse bonds payable from federal grants. It also excludes the bonds issued to fund the construction of the privately operated Teodoro Moscoso bridge, payable by the private operator primarily from bridge toll revenues, but which under certain circumstances could become an obligation of the Authority.

Ports Authority. The Authority owns and operates the major airport and seaport facilities in Puerto Rico. The Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of seaport equipment and property. In July 2005, the Authority ceased providing financial assistance to the Maritime Transportation Shipping Authority. As of December 31, 2005, the Authority had $497.0 million in debt, including $301.6 million under a line of credit with Government Development Bank.

Port of the Americas Authority. The Port of the Americas Authority is responsible for the development and operation of the Port of the Americas (the "Port"), a deep draft port on the south coast of Puerto Rico. In December of 2004, the first phase of the Port was completed at a cost of $40 million. The Authority is authorized to issue bonds guaranteed by the Commonwealth in a maximum aggregate principal amount of $250 million. The proceeds from these bonds will be used to continue the development of the Port. Currently, Government Development Bank is authorized to hold bonds of the Authority in an aggregate principal amount not to exceed $250 million. As of December 31, 2005, Government Development Bank had approximately $20.3 million of the Authority's outstanding bonds.

Solid Waste Authority. The Authority is responsible for the evaluation, development and execution of strategies for the rational management of solid waste, the protection of the environment and public health, and the conservation of Puerto Rico's natural resources. As of December 31, 2005, the Authority had two lines of credit with Government Development Bank with an aggregate outstanding principal of $74.9 million.

Special Communities Perpetual Trust. The Special Communities Perpetual Trust is an irrevocable and permanent trust created in November 2002 as a public corporation. The Trust's principal purpose is to fund development projects which address the infrastructure and housing needs of underprivileged communities. Act No. 271 of November 21, 2002 required Government Development Bank to make a special capital contribution to the Special Communities Perpetual Trust of $500 million and to provide the Trust a $500 million non-revolving line of credit. In December 2004, Government Development Bank transferred to the Special Communities Irrevocable Trust the required $500 million capital contribution and an additional $270.7 million, which represented the remaining undisbursed balance of the $500 million line of credit. The amounts transferred to the Special Communities Irrevocable Trust were deposited in two investment accounts held by Government Development Bank for the benefit of the Special Communities Perpetual Trust. As of December 31, 2005, the Special Communities Perpetual Trust had repaid $74.9 million of its line of credit and had an outstanding balance of $425.1 million. The line of credit is payable from legislative appropriations.

Loans to Municipalities

Government Development Bank also purchases general obligation and other bonds and notes of the municipalities of Puerto Rico, which obligations are issued by said municipalities to finance their public works projects and operational needs. The bonds and notes relating to public works projects are generally sold by Government Development Bank to MFA, which issues its bonds to acquire such bonds and notes. As of December 31, 2005, approximately $424 million aggregate outstanding principal amount of bonds and notes issued by the municipalities were held by Government Development Bank. On December 22, 2005, MFA closed a bond issuance of approximately $731 million. Certain of the bond proceeds were used to purchase approximately $405.6 million principal amount of the bonds and notes issued by the municipalities and held by Government Development Bank.

LOANS BY GOVERNMENT DEVELOPMENT BANK TO PRIVATE ENTERPRISES

Government Development Bank's loans to the private sector (not including the lending activities of its subsidiaries, Housing Finance Authority and Tourism Development Fund) are primarily for the establishment or expansion of manufacturing entities, the purchase of machinery and equipment, the construction of commercial and industrial buildings, and the construction of hotel and tourist facilities. Government Development Bank also provides working capital loans to the private sector. As of December 31, 2005, Government Development Bank's total outstanding loans to the private sector, excluding loans to the private sector by its subsidiaries, were $376,000, net of an allowance for loan losses of $259,000.

In its lending to the private sector, Government Development Bank does not compete with private lenders nor does it make loans to borrowers whose credit is not acceptable to such lenders. Government Development Bank offers longer maturities than are normally available from commercial banks and, where possible, participates in co-financing arrangements with private lenders. Guarantees by federal agencies are obtained whenever possible.

SUMMARY OF THE INDENTURE

The Notes will be issued pursuant to the Indenture between Government Development Bank and Banco Popular de Puerto Rico, as trustee. Government Development Bank may issue additional securities pursuant to the Indenture.

Events of Default and Remedies

Each of the following is an event of default under the Indenture with respect to the Notes:

(a) failure to pay any installment of interest on any of the Notes when the same shall become due and payable, and continuance of such default for a period of 30 days;

(b) failure to pay the principal of or premium, if any, on any of the Notes on the date it becomes due and payable, whether at maturity, redemption, acceleration or otherwise;

(c) failure to pay any sinking or purchase fund or analogous obligation when the same shall become due and payable;

(d) default under any indebtedness for borrowed money of Government Development Bank in excess of $10,000,000, if as a result of such default such indebtedness shall have become or been declared due and payable and such acceleration shall not have been rescinded or annulled within a period of 30 days after there has been given, by registered or certified mail, to Government Development Bank by the Trustee or to Government Development Bank and the Trustee by the holders of at least 25% in principal amount of the outstanding Notes, a written notice specifying such default and requiring it to be remedied and requiring Government Development Bank to cause such acceleration to be rescinded or annulled and stating that such notice is a "Notice of Default;"

(e) failure to comply with any other covenant of Government Development Bank set forth in the Indenture, and continuance of such default for a period of 90 days after there has been given, by registered or certified mail, to Government Development Bank by the Trustee or to Government Development Bank and the Trustee by the holders of at least 25% in principal amount of the outstanding Notes, a written notice specifying such default and requiring it to be remedied and stating that such notice is a "Notice of Default;" or

(f) certain events of bankruptcy, liquidation or similar proceedings involving Government Development Bank.

In case an event of default shall have occurred and be continuing with respect to the Notes, the Trustee may, and upon the direction of the holders of not less than 25% in aggregate principal amount of the Notes then outstanding shall, by notice in writing to Government

Development Bank, declare the principal amount of all the Notes then outstanding (if not then due and payable) to be due and payable immediately after the date of such notice and upon such declaration the same shall so become and be due and payable.

At any time after such a declaration of acceleration has been made with respect to the Notes, and before a judgment or decree for payment of the money due has been obtained by the Trustee, the holders of a majority in principal amount of the outstanding Notes, by written notice to Government Development Bank and the Trustee, may rescind and annul such declaration and its consequences if (i) Government Development Bank has paid or deposited with the Trustee a sum sufficient to pay (1) all overdue installments of interest on the Notes, (2) the principal of (and premium, if any, on) any Notes which have become due otherwise than by reason of such declaration of acceleration, and interest thereon, (3) interest upon overdue installments of interest at the rate or rates prescribed therefore by the terms of the Notes to the extent that payment of such interest is lawful, and (4) all sums paid or advanced by the Trustee and the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel and all other amounts due the Trustee under the Indenture and (ii) all Events of Default with respect to the Notes, other than the nonpayment of the principal of the Notes which have become due solely by reason of such declaration of acceleration, have been cured or waived.

Any monies collected by the Trustee with respect to the Notes shall be applied in the following order, after payment of all amounts due to the Trustee, at the date or dates fixed by the Trustee and, in case of the distribution of such money on account of principal (or premium, if any) or interest, upon presentation of the Notes and the notation thereon of the payment if only partially paid and upon surrender thereof if fully paid:

(a) If the principal amount of all the Notes shall not have become due and payable or shall not have been declared due and payable, all such moneys shall be applied first: to the payment to the persons entitled thereto of all installments of interest then due and payable in the order in which such installments became due and payable, with interest on such installments of interest, to the extent permitted by law, at the rate of such interest from the respective dates upon which such installments became due and payable, and, if the amount available shall not be sufficient to pay in full any particular installment, together with interest thereon, then to the payment first of the interest on such installment, ratably, according to the amount of such interest due on such date, and then to the payment of such installment, ratably, according to the amounts due on such installment, to the persons entitled thereto; second: to the payment to the persons entitled thereto of the unpaid principal of any Notes which shall have become due and payable in the order of their due dates, with interest on the principal amount of such Notes at the respective rates specified therein from the respective dates upon which such Notes became due and payable, and, if the amount available shall not be sufficient to pay in full the principal of the Notes due and payable on any particular date, together with such interest, then to the payment first of such interest, ratably, according to the amount of such interest due on such date, and then to the payment of such principal ratably, according to the amount of such principal due on such date, to the persons entitled thereto; and third: to the payment of the interest on and the principal of the Notes, and to the redemption of Notes, all in accordance with the provisions of the Indenture.

(b) If the principal of all the Notes shall have become due and payable or shall have been declared due and payable, all such moneys shall be applied to the payment of the principal and interest (including interest on any overdue installment of interest to the extent permitted by law) then due upon such Notes, without preference or priority of principal over interest or of interest over principal or of any installment of interest over any other installment of interest, or of any Note over any other Note, ratably, according to the amounts due respectively for principal, interest and premium, if any, to the persons entitled thereto.

(c) Whenever moneys are to be applied by the Trustee as described above, such moneys shall be applied by the Trustee at such times, and from time to time, as the Trustee in its sole discretion shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future; the setting aside of such moneys in trust for the proper purpose shall constitute proper application by the Trustee; and the Trustee shall incur no liability whatsoever to Government Development Bank, to any Noteholder or to any other person for any delay in applying any such moneys, so long as the Trustee acts diligently, having due regard to the circumstances, and ultimately applies the same in accordance with such provisions of the Indenture. Whenever the Trustee shall exercise such discretion in applying such moneys, it shall fix the date (which shall be an Interest Payment Date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee shall give such notice as it may deem appropriate of the fixing of any such date, and shall not be required to make payment to the holder of any Note until such Note shall be surrendered to the Trustee for appropriate endorsement, or for cancellation if fully paid.

The holders of a majority in aggregate principal amount of the Notes then outstanding may, on behalf of all such holders, waive any past default and its consequences, except a default not theretofore cured with respect to the payment of principal amount, premium, if any, or interest on any Note and certain other matters which require the consent of all the Noteholders. See "Amendments and Supplements to the Indenture" below.

The Trustee may require indemnification before taking any action under the Indenture other than (i) accelerating the principal amount of the Notes issued thereunder, when required by the Indenture, or (ii) taking certain ministerial actions.

The holders of a majority of the aggregate principal amount of Notes then outstanding will have, subject to certain limitations, the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee with respect to the Notes. No Noteholder will have any right to institute any suit, action or proceeding in equity or at law on any Note or for the execution of any trust under the Indenture, or for any other remedy under the Indenture unless: (i) such holder has previously given to the Trustee notice of the event of default on account of which such suit, action or proceeding is to be instituted; (ii) the holders of not less than 25% of the aggregate principal amount of Notes then outstanding have requested of the Trustee in writing, after the right to exercise such powers or right of action, as the case may be, has accrued, and have afforded the Trustee a reasonable opportunity, either to proceed to exercise such powers or to institute such action, suit or proceeding in its name; (iii) the Trustee has been offered reasonable security and indemnity against the costs, expenses and liabilities to be incurred; (iv) the Trustee has refused or neglected to comply with such request within 60 days after its receipt of notice from the required percentage of Noteholders; and (v) no direction inconsistent with such written request has been given to the Trustee during such 60-day period by the holders of a majority in principal amount of the outstanding Notes. Such notification, request and offer of indemnity are declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the powers and trusts of the Indenture or to any other remedy thereunder. No one or more Noteholders will have any right, in any manner, to affect, disturb or prejudice any rights under the Indenture, or to obtain or to seek to obtain priority or preference over any other Noteholders, or to enforce any right thereunder, except in the manner therein provided. All suits, actions and proceedings at law or in equity must be instituted, had and maintained in the manner provided in the Indenture and for the benefit of all Noteholders. Any individual right of action or other right given to one or more Noteholders by law is restricted by the Indenture to the rights and remedies therein provided. Nothing in the Indenture, however, shall impair the right of any Noteholder to enforce the payment of the principal amount of, premium, if any, and interest on any Note after its due date.

Amendments or Supplements to the Indenture

The Indenture may be amended or supplemented at any time without the consent or approval of any of the Noteholders (a) to cure any ambiguity or formal defect or omission, to correct or supplement any provision which may be inconsistent with any other provision, or to make any other changes with respect to matters or questions arising under the Indenture which shall not be inconsistent with the provisions of the Indenture; (b) to grant to or confer upon the Trustee for the benefit of the Noteholders or the holder of any other series of securities any additional rights, remedies, powers, benefits, authority or security that may lawfully be so assigned or conferred; (c) to add to the covenants of Government Development Bank, or to surrender any right or power herein conferred upon Government Development Bank, for the benefit of the Noteholders or the holders of any other series of securities; (d) to permit the qualification of the Indenture under the Trust Indenture Act of 1939 or any similar federal statute hereafter in effect or to permit the qualification of the Notes or any other series of securities for sale under the securities laws of any of the states of the United States, and to add such other terms, conditions and provisions as may be required by said Trust Indenture Act or similar federal statute; (e) to provide for the issuance of additional securities as described under "Additional Debt Securities" below; (f) to evidence and provide for the acceptance of appointment by another corporation as a successor trustee with respect to one or more series of securities and to add to or change any of the provisions of the Indenture as shall be necessary to provide for or facilitate the administration of the trusts hereunder by more than one trustee; (g) to comply with any requirements of the nationally recognized rating agency designated by Government Development Bank to rate the Notes or any other series of securities that is necessary in order for the Notes or such other securities to maintain the rating initially assigned or then applicable to them; or (h) to add any additional events of default in respect of the Notes or any other series of securities.

Other than for purposes of the above paragraph, the Indenture may be amended or supplemented with the consent of the holders of a majority in principal amount of the securities of each series affected by such amendment or supplement at the time outstanding under the Indenture; provided, however, that without the consent of every securityholder affected by such amendment or supplement, no such amendment or supplement may be adopted with respect to (a) a change in the maturity of the principal amount of or the interest, or any premium, on any security, or (b) a reduction in the principal amount of any security or the redemption premium, if any, or the rate of interest thereon, or (c) a reduction in the aggregate principal amount of the securities required for consent to such supplement or amendment or any waiver thereunder. The Trustee is not obligated to execute any proposed supplement or amendment if its rights, obligations and interests would be affected thereby.

Defeasance

Any outstanding Series B Note will be deemed to have been paid within the meaning of the Indenture when the whole amount of the principal of and interest on such Note has been paid or duly provided for and the conditions set forth in clause (c) below have been satisfied or when, among other things, (a) such Note has been duly called for redemption or irrevocable instructions to call such Note for redemption have been given to the Trustee, (b) there have been deposited with the Trustee either moneys in an amount which will be sufficient, or Government Obligations, which do not contain provisions permitting redemption at the option of the issuer, the principal of and interest on which when due, and without reinvestment, will provide moneys which, together with the moneys, if any, deposited with or held by the Trustee available therefor, will be sufficient, to pay when due the principal of and premium, if any, and interest due and to become due on such Note on or prior to the redemption date thereof, and (c) in the event such Note does not mature and is not to be redeemed within the next succeeding 60 days, Government Development Bank has given the Trustee irrevocable instructions to give, as soon as practicable, a notice to the holder of such Note stating that the deposit of moneys or Government Obligations described above has been made with the Trustee and that such Note is deemed to have been paid in accordance with the Indenture and stating the maturity or redemption date upon which moneys are to be available for the payment of the principal of and premium, if any, and interest on such Note.

Additional Debt Securities

In addition to the Notes being offered hereunder, Government Development Bank may authorize from time to time the issuance of additional debt securities under the Indenture or otherwise incur additional indebtedness. Such additional debt securities or other indebtedness may rank equally with the Notes offered hereunder and may have the benefit of any collateral specified in the resolution or supplement to the Indenture or other instrument pursuant to which such additional debt securities are issued.

Certain Rights of the Trustee

In the Indenture, Government Development Bank will agree (i) to pay to the Trustee from time to time reasonable compensation for all services rendered by it, (ii) to reimburse the Trustee upon its request for all reasonable expenses, disbursements and advances incurred or made by the Trustee in accordance with any provision of the Indenture (including the reasonable compensation and the expenses and disbursements of its agents and counsel), except any such expense, disbursement or advance as may be attributable to its negligence or bad faith; and (iii) to indemnify the Trustee for, and to hold it harmless against, any loss, liability or expense incurred without negligence or bad faith on its part, arising out of or in connection with the Indenture, including the costs and expenses of defending itself against any claim or liability in connection with the exercise or performance of any of its powers or duties.

As security for the performance of the obligations of Government Development Bank described in the preceding paragraph, the Trustee shall have a lien prior to the Notes upon all property and funds held or collected by the Trustee as such, except funds held in trust for the payment of principal of (and premium, if any) or interest on particular Notes.

In the performance of its duties (i) the Trustee may rely and shall be protected in acting or refraining from acting upon any resolution, opinion, direction, consent, order, or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties; (ii) the Trustee may consult with counsel and the advice of such counsel shall be full and complete authorization and protection in respect of any action taken, suffered or omitted by it hereunder in good faith and in reliance thereon; (iii) the Trustee shall be under no obligation to exercise any of the rights or powers vested in it by the Indenture at the request or direction of any of the Noteholders unless such Noteholders shall have offered to the Trustee reasonable security or indemnity against the costs, expenses and liabilities which might be incurred by it in compliance with such request or direction; (iv) the Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, opinion, report, notice, request, direction, consent or other paper or document, but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and if the Trustee shall determine to make such further inquiry or investigation, it shall be entitled to examine the relevant books, records and premises of Government Development Bank personally or by agent or attorney; and (v) the Trustee may execute any of its trusts or powers either directly or by or through agents or attorneys and the Trustee shall not be responsible for any misconduct or negligence on the part of any agent or attorney appointed with due care by it.

RATINGS

S&P and Moody's have rated the Series B Notes "BBB" and "Baa3," respectively. The ratings assigned by each of S&P and Moody's remain on CreditWatch and Watchlist, respectively, both with negative implications. Such ratings reflect only the respective view of such organizations and the explanation of the significance of such rating may be obtained only from S&P and/or Moody's. There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by such rating agencies if circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market prices of the Series B Notes.

S&P and Moody's have aligned the credit rating of Government Development Bank with that of the Commonwealth. Therefore, any change in the credit rating of the Commonwealth's debt obligations is likely to affect the credit rating of Government Development Bank's debt obligations, including the Series B Notes. See "Rating Actions Involving the Commonwealth and Government Development Bank" under *Recent Developments Relating to the Commonwealth* and "Liquidity and Sources of Funding" under *Finances of Government Development Bank*.

TAX EXEMPTION

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

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

Discount Notes

The excess, if any, of the amount payable at maturity of any maturity of the Series B Notes over the issue price thereof constitutes original issue discount. The amount of original issue discount that has accrued and is properly allocable to an owner of any maturity of the Series B Notes with original issue discount (a "Discount Note") will be excluded from gross income for federal income tax purposes to the same extent as interest on the Series B Notes. In general, the issue price of a maturity of the Series B Notes is the first price at which a substantial amount of Series B Notes of that maturity was sold (excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers) and the amount of original issue discount accrues in accordance with a constant yield method based on the compounding of interest. A purchaser's adjusted basis in a Discount Note will be increased by the amount of such accruing discount for purposes of determining taxable gain or loss on the sale, redemption or other disposition of such Discount Note for federal income tax purposes.

A portion of the original issue discount that accrues in each year to a Series B Note owner of a Discount Note that is a corporation will be included in the calculation of the corporation's federal alternative minimum tax liability. In addition, original issue discount that accrues in each year to an owner of a Discount Note is included in the calculation of the distribution requirements of certain regulated investment companies and may result in some of the collateral federal income tax consequences discussed herein. Consequently, an owner of a Discount Note should be aware that the accrual of original issue discount in each year may result in an alternative minimum tax liability, additional distribution requirements or other collateral federal income tax consequences although the owner of such Discount Note has not received cash attributable to such original issue discount in such year.

The accrual of original issue discount and its effect on the redemption, sale or other disposition of any maturity of a Discount Note that is not purchased in the initial offering at the first price at which a substantial amount of Discount Notes of that maturity is sold to the public may be determined according to rules that differ from those described above. An owner of a Discount Note should consult his tax advisor with respect to the determination for federal income tax purposes of the amount of original issue discount with respect to such Discount Note and with respect to state, Commonwealth and local tax consequences of owning and disposing of such Discount Note.

Premium Notes

The excess, if any, of the tax basis of a Series B Note to a purchaser (other than a purchaser who holds such Series B Note as inventory, stock in trade, or for sale to customers in the ordinary course of business) who purchases such Series B Note as part of the initial offering and at the initial offering price as set forth on the inside cover page over the amount payable at maturity of such Note is "Note Premium." Note Premium is amortized over the term of such Series B Note for federal income tax purposes (or in the case of a Series B Note with Note Premium callable prior to its stated maturity, the amortization period and yield may be required to be determined on a basis of a call date that results in the lowest yield on such Series B Note). No deduction is allowed for such amortization of Note Premium; however, United States Treasury regulations provide that Note Premium is treated as an offset to qualified stated interest received on the Series B Note. An owner of such Series B Note is required to decrease his adjusted basis in such Series B Note by the amount of amortizable Note Premium attributable to each taxable year such Series B Note is held. An owner of such Series B Note should consult his tax advisor with respect to the precise determination for federal income tax purposes of the treatment of Note Premium upon sale, redemption or other disposition of such Series B Note and with respect to the state, Commonwealth and local tax consequences of owning and disposing of such Series B Note.

Other

Ownership of tax-exempt obligations such as the Series B Notes may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations, certain S Corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers who may be eligible for the earned income tax credit.

Ownership of tax-exempt obligations such as the Series B Notes may also result in collateral income tax consequences under Puerto Rico law to financial institutions doing business in Puerto Rico.

Prospective purchasers of the Series B Notes should consult their tax advisors as to the applicability and impact of any collateral consequences.

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

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series B Notes from the Commonwealth at an aggregate discount of $4,254,443.30 from the initial offering prices of the Series B Notes set forth or derived from information set forth on the inside cover of this Official Statement. The obligations of the Underwriters are subject to certain conditions precedent, and they will be obligated to purchase all the Series B Notes, if any such notes are purchased. The Underwriters may offer to sell the Series B Notes to certain dealers and others at prices lower than the initial public offering prices. The offering prices may be changed, from time to time, by the Underwriters.

LEGAL MATTERS

The authorization and issuance of the Series B Notes is subject to the approval of legality by Sidley Austin LLP, New York, New York, Bond Counsel. The form of opinion of Sidley Austin LLP, which will be dated and premised on law in effect on the date of delivery of the Series B Notes, is set forth in *Appendix II* hereto.

LEGAL INVESTMENT

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

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the Securities and Exchange Commission (the "SEC"), Government Development Bank and the Commonwealth will agree to the following:

1. Each of Government Development Bank and the Commonwealth will agree to file, within 305 days after the end of each fiscal year, commencing with the fiscal year ending June 30, 2006, with each NRMSIR and with any Commonwealth state information depository ("SID"), core financial information and operating data for such fiscal year, including (i) its audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) on Government Development Bank and the Commonwealth, as the case may be, and information as to revenues, expenditures, financial operations and indebtedness of Government Development Bank and the Commonwealth, as the case may be, in each case, generally found or incorporated by reference in this Official Statement; and

2. Government Development Bank will agree to file, in a timely manner, with each NRMSIR or with the MSRB and with each Commonwealth SID, notice of any failure of Government Development Bank to comply with the paragraph above and of the occurrence of any of the following events with respect to the Series B Notes, if, in the judgment of Government Development Bank or its agent, such event is material:

    a. principal and interest payment delinquencies;
    b. non-payment related defaults;
    c. unscheduled draws on debt service reserves reflecting financial difficulties;
    d. unscheduled draws on credit enhancements reflecting financial difficulties;
    e. substitution of credit or liquidity providers, or their failure to perform;
    f. adverse opinions or events affecting the tax-exempt status of the Series B Notes;
    g. modifications to rights of the holders (including Beneficial Owners) of the Series B Notes;
    h. note calls;
    i. defeasances;

j. release, substitution, or sale of property securing repayment of the Series B Notes; and
k. rating changes.

Events (c), (d) and (e) are included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. However, events (c), (d) and (e) may not be applicable, since the terms of the Series B Notes do not provide for "debt service reserves," "credit enhancement" or "liquidity providers." In addition, with respect to the following events:

Events (d) and (e). Government Development Bank does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the Series B Notes, unless Government Development Bank applies for or participates in obtaining the enhancement.

Event (f). For information on the tax status of the Series B Notes, see *Tax Exemption*.

Event (h). Government Development Bank does not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if the terms, dates and amounts of redemption are set forth in detail in this Official Statement under "Redemption" under *The Series B Notes*, the only open issue is which Series B Notes will be redeemed in the case of a partial redemption, notice of redemption is given to the Noteholders as required under the terms of the Series B Notes, and public notice of the redemption is given pursuant to Securities Exchange Act of 1934 Release No. 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or Series B Note purchases.

The Commonwealth and Government Development Bank expect to provide the information described in paragraph 1 above by filing their respective first bond official statement that includes such information for the preceding fiscal year or, if no such official statement is issued by the 305-day deadline, by filing a separate document containing such information.

The Commonwealth has made similar continuing disclosure covenants in connection with its prior bond issuances, and has complied with all such covenants, except as hereinafter noted. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2002 were filed after the Commonwealth's filing deadline of May 1, 2003, because of delays in finalizing such financial statements resulting from the implementation of GASB 34. The Commonwealth's audited financial statements for the fiscal year ended June 30, 2003 were also filed after the Commonwealth's filing deadline of April 30, 2004, because of delays in finalizing the financial statements of certain of the Commonwealth's reporting units due to the implementation of GASB 34.

As of the date of this Official Statement, there is no Commonwealth SID, and the NRMSIRs are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor's Securities Evaluations, Inc., 55 Water Street, 45th Floor, New York, New York 10041; FT Interactive Data, Attn: NRMSIR, 100 William Street, 15th Floor, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

Government Development Bank may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of Government Development Bank, such other events are material with respect to the Series B Notes, but Government Development Bank does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

Government Development Bank and the Commonwealth acknowledge that its undertaking pursuant to the Rule described above is intended to be for the benefit of the Beneficial Owners of the Series B Notes, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of Government Development Bank's or the Commonwealth's obligations thereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with Government Development Bank and the Commonwealth written notice of any request to cure such breach, and Government Development Bank or the Commonwealth, as applicable, shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan, Puerto Rico for the equal benefit of all Beneficial Owners of the outstanding Series B Notes benefited by the Covenants, and no remedy shall be sought or granted other than specific performance of any of the Covenants at issue. Moreover, Proceedings filed by Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Sections 2 and 2A of Act No. 104, approved on June 29, 1955, as amended, which governs the scope of legal actions against the Commonwealth, substantially limits the amount of monetary damages that may be awarded against the Commonwealth, and provides certain notice provisions, the failure to comply with which may further limit any recovery.

The Covenants may only be amended if:

(1) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of Government Development Bank or the Commonwealth, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the Series B Notes, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interest of Beneficial Owners, as determined by persons unaffiliated with Government Development Bank or the Commonwealth; or

(2) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the adoption of such Rule, ceases to be in effect for any reason, and Government Development Bank

or the Commonwealth, as applicable, elects that the Covenants shall be deemed amended accordingly.

Government Development Bank and the Commonwealth have further agreed that the annual financial information containing any amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

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

The Covenants have been made in order to assist the Underwriters in complying with the Rule.

LITIGATION

Government Development Bank is involved in various lawsuits arising in the normal course of its business. With respect to pending and threatened litigation, as of December 31, 2005, Government Development Bank has included in its financial statements reported liabilities of approximately $2.2 million for awarded and anticipated unfavorable judgments. This amount represented the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. In the opinion of Government Development Bank and its General Counsel, the ultimate liability in excess of amounts provided in the financial statements, if any, would not be significant.

On August 6, 2003, the Tourism Development Fund, a subsidiary of Government Development Bank, initiated foreclosure proceedings on the mortgage note it holds as collateral for its guarantee of the bonds issued by AFICA in connection with the development of the Cayo Largo Hotel. The indenture pursuant to which the bonds were issued requires the repayment of the bonds before the execution of the mortgage note. Therefore, prior to initiating foreclosure proceedings in order to execute the mortgage note, the Tourism Development Fund obtained a line of credit from Government Development Bank to repay the outstanding balance of the bonds. The outstanding principal amount of such bonds was $75.6 million. The Tourism Development Fund believes that the loss allowance established for this project is adequate.

As a result of the aforementioned foreclosure proceedings, several of the parties involved in the development of the Cayo Largo Hotel have counterclaimed against the Tourism Development Fund alleging breach of contract and damages of approximately $210 million. In addition, the insurance company that issued the performance and payment bond in connection with the construction and development of the project filed an action seeking a declaratory judgment to the effect that it is not bound to perform under such bond. The Tourism Development Fund believes that its ultimate liability with respect to the development of the Cayo Largo Hotel, if any, would not be significant.

MISCELLANEOUS

Appended to and constituting a part of this Official Statement are the Financial Statements of Government Development Bank as of and for the year ended June 30, 2005 (*Appendix I*) and the form of opinions of Sidley Austin LLP, Bond Counsel (*Appendix II*).

The financial statements of Government Development Bank for Puerto Rico as of and for the year ended June 30, 2005, included in *Appendix I* to this Official Statement, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report appearing therein.

Government Development Bank will provide, when available, copies of its annual audited financial statements and other pertinent credit information relevant to the Series B Notes to any Noteholder who requests the same in writing to Government Development Bank for Puerto Rico, 666 Fifth Avenue, 15th Floor, New York, NY 10103-1599.

GOVERNMENT DEVELOPMENT BANK
FOR PUERTO RICO

By: /s/ Alfredo Salazar
Acting President

Government Development Bank for Puerto Rico

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information as of and for the Year Ended June 30, 2005, and Independent Auditors' Report

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

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AS OF AND FOR THE YEAR ENDED JUNE 30, 2005

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INDEPENDENT AUDITORS' REPORT

To the Members of the Board of Directors of
Government Development Bank for Puerto Rico

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, as of and for the year ended June 30, 2005, which collectively comprise the Bank's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the respective 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 respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, 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, 2005, and the respective changes in financial position and respective cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 to 16 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of Bank's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

October 28, 2005

Stamp No. 2100878
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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2005

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, 2005. The information presented here should be read in conjunction with the basic financial statements, including the notes thereto.

(1) Financial Highlights

- Assets and liabilities of the Bank at June 30, 2005 amounted to $10,366 million and $8,404 million, respectively, for net assets of $1,962 million or 19% of total assets.
- Net assets decreased during the fiscal year by $354 million. The decrease in net assets comprises $343 million from business-type activities due to a $500 million contribution to the Special Communities Irrevocable Trust Fund, and $11 million from governmental activities.

(2) 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.

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 assets provides information on the Bank's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets 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 assets changed during the reporting period. Changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

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 enterprise 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 statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

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

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.

(3) Government-wide Financial Analysis

Total assets and total liabilities of the Bank at June 30, 2005 amounted to $10,366 million and $8,404 million, respectively, for net assets of $1,962 million or 19% of total assets. From the $1,962 million in net assets, $1,570 million or 80% are unrestricted, $273.5 million or 14% are restricted for use in affordable housing programs, and the remaining 6% are invested in capital assets, restricted for debt service, and for the mortgage loan insurance program. Governmental and business-type activities are discussed separately in the following subsections.

Governmental Activities

Total assets of governmental activities amounted to $238 million at June 30, 2005, before $100 million in net balances due to business-type activities. Total liabilities amounted to $131.1 million, for net assets of $6.3 million or 4.6% of total assets net of balances due to business-type activities. Net assets have been broken down into the amounts restricted for debt service of $53.4 million and for affordable housing programs of $41.6 million, and the unrestricted deficit of $88.7 million, which means that the restrictions existing 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 all its obligations.

Condensed financial information on assets, liabilities, and net assets of governmental activities as of June 30, 2005 and 2004 is shown below (amounts in thousands):

	June 30		Change	
	2005	2004	Amount	Percent
Assets:				
Restricted:				
Cash and due from banks, and deposits placed with banks	$ 6,730	$ 7,669	$ (939)	(12.2)%
Due from federal government	20,450	15,595	4,855	31.1%
Investments and investment contracts	200,296	235,730	(35,434)	(15.0)%
Loans receivable–net	6,577	4,860	1,717	35.3%
Other assets	3,786	5,469	(1,683)	(30.8)%
Total assets before internal balances	237,839	269,323	(31,484)	(11.7)%
Internal balances	(100,434)	(117,217)	16,783	(14.3)%
Total assets	137,405	152,106	(14,701)	(9.7)%
Liabilities:				
Accounts payable and accrued liabilities	42,673	10,283	32,390	315.0%
Notes payable:				
Due in one year	96		96	9,600.0%
Due in more than one year	10,244	10,339	(95)	(0.9)%
Bonds payable:				
Due in one year	36,420	36,105	315	0.9%
Due in more than one year	41,650	78,070	(36,420)	(46.7)%
Total liabilities	131,083	134,797	(3,714)	(2.8)%
Net assets:				
Restricted for debt service	53,374	57,406	(4,032)	(7.0)%
Restricted for affordable housing programs	41,645	77,451	(35,806)	(46.2)%
Unrestricted deficit	(88,697)	(117,548)	28,851	(24.5)%
Total net assets	$ 6,322	$ 17,309	$ (10,987)	(63.5)%

Investments and investment contracts amounted to $200.3 million and account for the majority of assets held by governmental activities. These investments, together with cash and due from banks, and deposits placed with banks of $6.7 million are held to provide the funds necessary for the execution of the various affordable housing programs managed by the Puerto Rico Housing Finance Authority and, to some extent, for debt service. Governmental activities also have a balance due from the federal government of $20.5 million that is related to the reimbursement of eligible expenses incurred in the New Secure Housing Program.

The most significant liabilities of governmental activities are the bonds and notes payable amounting to $78.1 million and $10.3 million at June 30, 2005, respectively. During the year, principal payments to service the bonds amounted to $36.1 million.

Condensed financial information on expenses, program and general revenues, and changes in net assets of governmental activities for the years ended June 30, 2005 and 2004 is shown below (amounts in thousands):

	Year ended June 30, 2005		
	General Government	Housing Assistance Programs	Total
Expenses	$ 1,965	$ 273,687	$ 275,652
Program revenues:			
Charges for services – financing and investment		15,508	15,508
Operating grants and contributions	-	265,171	265,171
Net (expenses) revenues	$ (1,965)	$ 6,992	5,027
Transfers			(16,014)
Change in net assets			(10,987)
Net assets–beginning of year			17,309
Net assets–end of year			$ 6,322

	Year ended June 30, 2004		
	General Government	Housing Assistance Programs	Total
Expenses	$ 1,511	$ 133,073	$ 134,584
Program revenues:			
Charges for services – financing and investment		16,791	16,791
Operating grants and contributions	-	134,213	134,213
Net (expenses) revenues	$ (1,511)	$ 17,931	16,420
General revenues–unrestricted income			1,026
Transfers			(16,283)
Change in net assets			1,163
Net assets–beginning of year			16,146
Net assets–end of year			$ 17,309

Total expenses of governmental activities amounted to $275.7 million for the year ended June 30, 2005, an increase of $141.1 million or 104.8% with respect to the prior year. Expenses for housing assistance programs increased by $140.6 million or 105.7% with respect to the prior year. This increase is driven mostly by an increase in subsidies of the Key for Your Home Program and the New Secure Housing Program, which increased $18 million and $17 million, respectively. In addition, during fiscal year 2005 U.S. Housing Act Section 8 programs were reclassified from the Housing Finance Authority business type activities to governmental activities. Expenses for these programs amounted to $113.8 million during fiscal year 2005.

Revenues from financing and investing activities provided $15.5 million in 2005 and $16.8 million in 2004 to be used for the benefit of the housing assistance programs. The decrease in revenues from financing and investing activities is due to a decrease in the average balance of investments during fiscal year 2005. Grants received for housing assistance programs amounted to $265.2 million in 2005 compared to $134.2 million in 2004. The increase is mainly related to an increase in reimbursements from the federal government for eligible expenses incurred in the New Secure Housing Program. In addition, during fiscal year 2005 U.S. Housing Act Section 8 programs were reclassified from the Housing Finance Authority business type activities to governmental activities. Revenues for these programs amounted to $113.8 million during fiscal year 2005.No grants were received during the year to service long-term debt.

Transfers for the year include $16 million in net transfers to business-type activities, primarily related to the transfer of residual balances of governmental funds that were used for debt service by the enterprise funds of the Affordable Housing Mortgage Subsidy Program (AHMSP).

Business-Type Activities

Condensed financial information on assets, liabilities, and net assets as of June 30, 2005 and 2004 is presented below (amounts in thousands):

	June 30,		Change	
	2005	2004	Amount	Percent
Assets:				
Cash and due from banks	$ 68,467	$ 54,037	$ 14,430	26.7%
Federal funds and securities purchased under agreements to resell	1,651,000	1,003,927	647,073	64.5%
Deposits placed with banks	350,503	308,704	41,799	13.5%
Investments and investment contracts	2,115,873	3,040,625	(924,752)	(30.4)%
Loans receivable–net	5,659,239	4,199,022	1,460,217	34.8%
Interest and other receivables	146,955	133,684	13,271	9.9%
Due from Puerto Rico Department of Housing	13,050	16,162	(3,112)	(19.3)%
Capital assets	25,277	15,204	10,073	66.3%
Other assets	97,922	182,026	(84,104)	(46.2)%
Internal balances	100,435	117,218	(16,783)	(14.3)%
Total assets	10,228,721	9,070,609	1,158,112	12.8%
Liabilities:				
Deposits:				
Demand	1,674,501	1,703,532	(29,031)	(1.7)%
Certificates of deposit	3,198,159	2,109,362	1,088,797	51.6%
Certificates of indebtedness	261,056	251,799	9,257	3.7%
Securities sold under agreements to repurchase	439,034	160,000	279,034	174.4%
Commercial paper	1,191,202	918,410	272,792	29.7%
Accrued interest payable	23,609	11,766	11,843	100.7%
Due to Commonwealth of Puerto Rico		8,397	(8,397)	(100.0)%
Accounts payable, accrued liabilities and other liabilities	83,866	104,054	(20,188)	(19.4)%
Bonds and notes payable:				
Due in one year	71,715	66,408	5,307	8.0%
Due in more than one year	1,329,738	1,438,053	(108,315)	(7.5)%
Total liabilities	8,272,880	6,771,781	1,501,099	22.2%
Net assets:				
Invested in capital assets	25,277	15,204	10,073	66.3%
Restricted for:				
Affordable housing programs	231,006	225,710	5,296	2.3%
Mortgage loan insurance	40,383	35,676	4,707	13.2%
Unrestricted	1,659,175	2,022,238	(363,063)	(18.0)%
Total net assets	$ 1,955,841	$ 2,298,828	$ (342,987)	(14.9)%

Federal Funds Sold, Securities Purchased Under Agreement to Resell, and Deposits Placed with Banks

Federal funds and securities purchased under agreements to resell increased by $647 million or 64.5%, from $1,004 million at June 30, 2004 to $1,651 million at June 30, 2005. Deposits placed with banks amounted to $350.5 million at June 30, 2005 compared to $308.7 million at June 30, 2004. Both increases respond primarily to the increase in total deposits.

Investments and Investment Contracts

Investments and investment contracts held in business-type activities amounted to $2,116 million at June 30, 2005. This amount represents a decrease of $925 million or 30.4% when compared to prior year balance. This decrease is mainly due to the net effect of a reduction in the investments portfolio of the GDB Enterprise Fund and the Puerto Rico Housing Finance Authority Enterprise Fund of $833 million and $80.3 million, respectively.

The investment portfolio comprised 21% of the total assets of the Bank's business-type activities at June 30, 2005, compared to 34% at the close of fiscal year 2004. Within the investment securities portfolio, $1,403 million at June 30, 2005 and $1,344 million at June 30, 2004 were restricted or pledged as collateral or payment source for specific borrowings.

Loans Receivable

Net loans receivable of $5,659 million accounted for 55% of total assets of business-type activities at June 30, 2005 (46% in 2004). The increase of $1,460 million in net loans was driven by an increase in public sector loans, where the largest increase was in loans to the Department of the Treasury of the Commonwealth of Puerto Rico (the "Department of the Treasury") including temporary financing to be repaid with certain federal grants.

Most of the public sector loans have designated repayment sources available through appropriations in the Commonwealth of Puerto Rico's (the "Commonwealth") budget in upcoming fiscal years. The Legislature generally has approved these appropriations to assist certain public sector entities in repaying their loans with the Bank. Furthermore, and in accordance with Act No. 164 of December 17, 2001, the Bank is not allowed to originate loans without a specific source of repayment being identified beforehand. Act No. 164 permits the Bank to originate new loans up to $100 million without a prior legislative approval but needs an authorization in writing from both the Commonwealth's Governor and the Director of the Office of Management and Budget. The Bank has not charged-off any loans from the public sector portfolio and, accordingly, does not establish an allowance for loan losses for any of these loans.

Private sector loans outstanding at June 30, 2005 and 2004 amounted to $418 million and $518 million, respectively, net of allowance for loan losses of $55 million and $45 million, respectively.

Capital Assets

Capital assets, net of accumulated depreciation, amounted to $25.3 million at June 30, 2005, an increase of $10.1 from prior year. The increase was driven by the construction project of the new headquarters for the Bank, which will house all the component units and other affiliated entities. For additional information on the activity of capital assets during the year, see Note 7 to the basic financial statements.

Deposits

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

Demand deposits and certificates of deposit had a combined net increase of $1,060 million from $3,813 million at June 30, 2004. The primary reason for this increase is an increase in the Department of the Treasury and private entities deposits, the latter as a result of the Bank's financing diversification policy.

Commercial Paper

Commercial paper increased by 29.7% from $918.4 million at June 30, 2004 to $1,191.2 million at June 30, 2005. The increase is directly related to the corresponding increase in loans receivable which are in part funded with commercial paper.

Other Borrowed Funds

Bonds and notes payable decreased by 6.8% from $1,504 million at June 30, 2004 to $1,401 million at June 30, 2005. This decrease is mainly due to the effect of the scheduled repayments of debt. For additional information on the activity of bonds payable during the year, see note 12 to the basic financial statements.

Condensed financial information on expenses, program revenues, and changes in net assets for business-type activities for the years ended June 30, 2005 and 2004 is presented below (amounts in thousands):

	Year ended June 30, 2005			
		Program revenues		
		Charges for services		
Activity	**Expenses**	**Fees, commissions, and other**	**Financing and investment**	**Net revenues (expenses)**
GDB Operating Fund	$ 687,779	$ 9,018	$ 297,637	$ (381,124)
Housing Finance Authority	105,521	25,445	94,815	14,739
Tourism Development Fund	16,202	9,731	10,124	3,653
Public Finance Corporation	53		20	(33)
Capital Fund	87	9	1,159	1,081
Development Fund	60	1	2,845	2,786
Other nonmajor	108		5	(103)
Total	$ 809,810	$ 44,204	$ 406,605	(359,001)
Transfers from governmental activities				16,014
Change in net assets				(342,987)
Net assets–beginning of year				2,298,828
Net assets–end of year				$ 1,955,841

	Year ended June 30, 2004				
		Program revenues			
		Charges for services			
Activity	Expenses	Fees, commissions, and other	Financing and investment	Operating grants and contributions	Net revenues (expenses)
GDB Operating Fund	$136,284	$ 17,666	$254,398	$	$ 135,780
Housing Finance Authority	219,259	21,101	82,693	113,744	(1,721)
Tourism Development Fund	13,373	7,432	4,569		(1,372)
Public Finance Corporation	7,779	8,944	228		1,393
Capital Fund	121	-	10,654		10,533
Development Fund	95	-	1,852		1,757
Other nonmajor	101	-	1		(100)
Total	$377,012	$ 55,143	$354,395	$113,744	146,270
Special items:					
Special Communities Trust					(3,340)
Net gain on early extinguishment of bond					(18)
Transfers from governmental activities					16,283
Change in net assets					159,195
Net assets–beginning of year					2,139,633
Net assets–end of year					$2,298,828

Activities presented in the statement of activities coincide with the major enterprise funds of the Bank. GDB Operating Fund generated financing and investment revenues of $297.6 million from its loan and investment portfolios and generated $9 million in other charges for services. These revenues covered $185.3 million in expenses for net revenues from GDB Operating Fund of $121.4 million, surpassing the net revenues of any other activity.

In December 2004, the Bank made a contribution of $500 million to the Special Communities Irrevocable Trust Fund as per the Legislature's Joint Resolution No. 1027 of November 21, 2002 (see Note 19). The net effect of total revenues and transfers of $159.5 million and said contribution resulted in the decrease in net assets of $343 million.

The Housing Finance Authority activities were the second largest contributor to the change in net assets with net revenues of $14.7 million. Other contributors to the change in net assets were the Tourism Development Fund and the Development Fund with net revenues of $3.7 million and $2.8 million, respectively.

(4) Analysis of Fund Financial Statements

Governmental Funds

Through its blended component unit, the Puerto Rico Housing Finance Authority (the "Authority"), the Bank has six major governmental funds: five special revenue funds and one debt service fund. Following, we provide an analysis of the financial position and changes in financial position of these major governmental funds.

Affordable Housing Mortgage Subsidy Program (AHMSP) (Stage 8)

This fund is the Stage 8 of the AHMSP of the Authority. The fund's operating objective is to provide funds for low-income families to be used for the down payment on mortgages subsidy payments. The fund receives appropriations from the Commonwealth to fund these payments.

In overall, the fund's net assets decreased approximately $17 million (43%) during the year 2005, mainly caused by an interfund transfer of $61 million to The Key For Your Home Program fund to support that fund's activities and operations. See further discussion below under *Key For Your Home Program*.

Affordable Housing Mortgage Subsidy Program (Stage 9)

This fund is the Stage 9 of the AHMSP of the Authority. The fund's operating objective is to provide funds for low-income families to be used for the down payment on mortgages subsidy payments. The fund receives appropriations from the Commonwealth to fund these payments. During the year ended June 30, 2005, this fund received intergovernmental revenue from the Commonwealth of Puerto Rico of $31 million, which was used to repay a portion of the amount due to the Government Development Bank for Puerto Rico.

Subsidy Prepayment Refunding Bonds – Debt Service

This fund is used to account for the resources available for the payment of certain bonds that were issued for the prepayment of subsidies. The fund received Commonwealth appropriations of approximately $32 million during 2005. The debt service requirements amounted to approximately $33 million during 2005. At June 30, 2005 and 2004, total bonds payable outstanding through this debt service fund amounted to approximately $61 and $89 million, respectively.

New Secure Housing Program

This fund is used to account for the resources available under the New Secure Housing Program to provide housing assistance benefits for specific participants that were affected by Hurricane Georges in 1998. This fund receives resources from the federal government, under the Federal Emergency Management Agency program, intended to provide financial resources to eligible participants for the reconstruction of their homes.

During the fiscal years 2005 and 2004, this fund recognized revenues from the federal government and the Commonwealth appropriations of approximately $30 and $22 million, respectively. Funds are requested from the federal government as eligible expenditures are incurred.

Expenditures during the years ended June 30, 2005 and 2004 amounted to $43 million and $26 million, respectively, which are presented as housing assistance payments in the accompanying statement of revenues, expenditures, and changes in fund balances—governmental funds. The increase in eligible expenditures is in direct relation to the number of projects being developed and financed through this fund. At June 30, 2005, there are 15 projects with 2,000 housing units under construction.

The Key for Your Home Program

This fund accounts for the subsidy to low- and moderate-income families with costs directly related to the purchase and rehabilitation of housing units. Total net assets decreased by $17 million compared to 2004. The fund had expenditures of $98 million, an increase of $18 million, or 22%, from 2004. The fund also received $82 million of transfers from other funds, mainly from Affordable Housing Mortgage Subsidy Program (Stage 8) ($61 million), and the nonmajor funds Stage 2 ($9,530), and Stage 7 ($11,551). Law 124, Affordable Housing Mortgage Subsidy Program, allows for the transfer of fund surplus identified in other Stages under the law to be used by the Key for your Home Program fund.

HUD Programs

This 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. This fund had total revenues and expenditures of $113.8 each for the year ended June 30, 2005. In fiscal year 2004, this fund also had $113.8 in revenues and expenditures, which were presented in the Housing Finance Authority enterprise fund.

Enterprise Funds

Following is a discussion of the most significant changes in the Bank's enterprise funds. Our main focus will be on the GDB Operating Fund, since separate basic financial statements are issued for each of the Bank's other major enterprise funds, which are blended component units.

GDB Operating Fund

Total assets of the GDB Operating Fund amounted to $8,724 million at June 30, 2005, compared to $7,471 million at June 30, 2004. The reduction in the combined balance of federal funds and securities purchased under agreements to resell, deposits placed with banks, and investments and investment contracts along with the net increase in total deposits were in part invested in loans, which increased by $1,538 million or 38.7%. Total liabilities increased by $1,635 million to $7,504 million at June 30, 2005. The most significant increase was in deposits that increased $1,165 million from $4,351 million to $5,516 million at June 30, 2005. As previously discussed, the source of the deposits increase is a growth of the Department of the Treasury deposits and of deposits from the private sector as a result of the Bank's efforts in diversifying its funding sources. Commercial paper increased 29.7% or $272.8 million from $918.4 million outstanding at June 30, 2004 to $1,191.2 million at June 30, 2005.

Change in net assets of the GDB Operating Fund (excluding the $500 million contribution to the Special Communities Irrevocable Trust Fund) decreased 13.2% from $136.9 million in 2004 to $118.9 million in 2005. Following we discuss the various components of the change in net assets of the GDB Operating Fund, compared to the prior year.

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

Net interest income, the difference between interest income and interest expense, decreased from $178.2 million in 2004 to $141.1 million in 2005. Interest expense increased by 91%, or from $77.5 million to $148 million, while interest income increased by 13% or from $255.7 million to $289.1 million. The decrease in net interest income can be attributed to the increase in interest expense associated to a higher volume of deposits and to the increases in interest rate made by the Federal Reserve. Said increases totaled 2% for 2005.

The change in fair value of investments increased from a negative $1.3 million in 2004 to a positive $8.5 million in 2005. The Bank's investment portfolio behaves inversely to the Treasury yield curve; thus, when the yield decreases, the Bank's investments generally increase in value.

(b) Provision for Losses on Loans, Guarantees, and Letters of Credit

In 2005, after a reevaluation of its private sector loan portfolio, the GDB Operating Fund had recorded an adjustment of $210,000 to increase the allowance. However, a partial collection of a previous charged-off loan resulted in a net recovery of $1.9 million.

No provision for losses on guarantees and letters of credit was recorded in 2005 and 2004 by the GDB Operating Fund as the allowance was considered adequate.

(c) Noninterest Income

Fiscal agency fees income decreased 50% from $8.4 million in 2004 to $4.2 million in 2005.

The decrease in other income of $3.5 million is due to last year transfer of $4.7 million related to the Public Finance Corporation's asset liquidation, in connection with the tax liens transaction. The receipt of this transfer helped the Bank recover part of prior years' losses sustained after the tax liens transaction.

(d) Noninterest Expenses

Salaries and fringe benefits increased by 9.5% from $23 million in 2004 to $25.2 million in 2005. The $2.2 million increase includes $1.6 million for salary expense increase, and $564,000 of net increase in benefits.

The decrease of 32% in legal and professional fees is due to less activity in projects entailing management consulting services.

(e) Nonoperating Expenses

The Bank made a $500 million contribution to the Special Communities Irrevocable Trust Fund in 2005. Due to this contribution, the Bank had a decrease in net assets which impeded it to make the mandatory contribution to the General Fund of the Commonwealth pursuant to Act No. 82 of June 16, 2004.

Puerto Rico Housing Finance Authority

Total net assets of the Puerto Rico Housing Finance Authority's enterprise funds increased by $30.8 million or 6.1% during the year. This change resulted from a net interest income of $10 million, provision for loan losses of $3.5 million, noninterest income of $22.6 million, including $2.9 million negative change in the fair value of investments, noninterest expenses of $14.3 million, and net transfers from governmental funds of $16 million.

Capital Fund

The Capital Fund's total net assets increased $1.1 million or 1.6% during the year to $70.3 million at June 30, 2005. This increase is mainly attributed to interest income of $984,000 and an increase in the fair value of investments of $174,000.

Development Fund

Net assets of the Development Fund increased by $2.8 million or 8.9% during the year to $34.1 million at June 30, 2005. This increase is attributed to the collection of $4.1 million in dividends from the venture capital investments, net of a decrease in the fair value of investments of $1.2 million.

Tourism Development Fund

Total assets decreased to $345.4 million from $372.7 million in 2004. This decrease can be attributed to the sale of the Martineau Bay Resort. With the proceeds of this sale, the Tourism Development Fund repaid the related financing it had with the Bank, and recognized a gain on sale of $2.3 million. At June 30, 2005, outstanding guarantees and letter of credit of the Tourism Development Fund stood at $167.7 million. Net assets of the Tourism Development Fund increased by $3.7 million or 4% during the year to $98.4 million at June 30, 2005. The change mostly results from a net interest income of $1.4 million, noninterest income of $9.7 million, including, the recognition of $3 million of deferred revenues and the above-mentioned gain of $2.3 million, net of the provision for loan losses of $6.5 million and noninterest expenses of $800,000.

Public Finance Corporation

The Public Finance Corporation's total net assets decreased by $34,000 or 3.2% during the year to $1 million at June 30, 2005. The decrease is attributed to a reduction in interest income driven by the exit of $4.7 million in funds. The exit of such funds is associated to the settlement agreement related to the tax liens transaction.

(5) Debt

Total bonds and notes outstanding at year-end amounted to $1,401 million of which $1,117 million are payable from restricted assets held by the Puerto Rico Housing Finance Authority. There were no new bonds issued during the year on the enterprise funds. Repayments and other reductions in debt outstanding aggregated $115.2 million. See Note 12 to the basic financial statements for additional information on debt activities during the year.

(6) Contacting the Bank's Financial Management

This report is designed to provide all interested 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 ASSETS
AS OF JUNE 30, 2005

ASSETS	Governmental Activities	Business-type Activities	Total
Cash and due from banks	$ -	$ 42,535,591	$ 42,535,591
Federal funds sold		1,411,000,000	1,411,000,000
Deposits placed with banks		340,000,000	340,000,000
Investments and investment contracts		940,308,261	940,308,261
Loans receivable–net		5,648,911,704	5,648,911,704
Accrued interest receivable		142,073,127	142,073,127
Due from Puerto Rico Department of Housing		13,049,826	13,049,826
Internal balances	(100,434,504)	100,434,504	-
Restricted assets:			
Cash and due from banks	2,530,484	25,931,108	28,461,592
Securities purchased under agreements to resell		240,000,000	240,000,000
Deposits placed with banks	4,200,014	10,503,127	14,703,141
Due from federal government	20,450,310		20,450,310
Investments and investment contracts	200,295,654	1,175,565,261	1,375,860,915
Loans receivable–net	6,576,772	10,327,507	16,904,279
Interest and other receivables	1,109,638	4,881,974	5,991,612
Real estate available for sale		2,134,883	2,134,883
Other assets		7,025,162	7,025,162
Real estate available for sale		23,558,344	23,558,344
Capital assets		25,277,181	25,277,181
Other assets	2,676,355	65,203,482	67,879,837
TOTAL	137,404,723	10,228,721,042	10,366,125,765
LIABILITIES			
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:			
Demand	-	1,674,501,051	1,674,501,051
Certificates of deposit		3,198,159,133	3,198,159,133
Certificates of indebtedness		261,055,703	261,055,703
Securities sold under agreements to repurchase		199,034,000	199,034,000
Commercial paper		1,191,202,415	1,191,202,415
Accrued interest payable	682,987	19,791,086	20,474,073
Notes payable, due within one year	95,748	17,540,291	17,636,039
Accounts payable and accrued liabilities	41,989,934	71,254,412	113,244,346
Allowance for losses on guarantees and letters of credit		6,269,360	6,269,360
Bonds payable due in more than one year		267,000,000	267,000,000
Notes payable due in more than one year	10,243,583		10,243,583
Liabilities payable from restricted assets:			
Securities sold under agreements to repurchase		240,000,000	240,000,000
Accrued interest payable		3,818,315	3,818,315
Accounts payable and accrued liabilities		6,341,821	6,341,821
Bonds payable:			
Due in one year	36,420,000	54,174,868	90,594,868
Due in more than one year	41,650,000	1,062,738,002	1,104,388,002
Total liabilities	131,082,252	8,272,880,457	8,403,962,709
NET ASSETS			
Invested in capital assets		25,277,181	25,277,181
Restricted for:			
Debt service	53,373,737		53,373,737
Mortgage loan insurance		40,383,280	40,383,280
Affordable housing programs	41,645,145	231,005,339	272,650,484
Unrestricted net assets (deficit)	(88,696,411)	1,659,174,785	1,570,478,374
Total net assets	$ 6,322,471	$ 1,955,840,585	$ 1,962,163,056

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
FOR THE YEAR ENDED JUNE 30, 2005

		Program Revenues			Net Revenues (Expenses) and Changes in Net Assets		
	Expenses	Charges for Services - Fees, Commissions, and Others	Charges for Services - Financing and Investment	Operating Grants and Contributions	Governmental Activities	Business-type Activities	Total
Functions/programs:							
Governmental activities:							
General government and other	$ 1,964,488	$ -	$ -	$ -	$ (1,964,488)	$ -	$ (1,964,488)
Housing assistance programs	273,687,220	-	15,507,950	265,171,382	6,992,112	-	6,992,112
Total governmental activities	275,651,708	-	15,507,950	265,171,382	5,027,624	-	5,027,624
Business-type activities:							
GDB Operating Fund	687,779,627	9,017,845	297,637,622			(381,124,160)	(381,124,160)
Housing Finance Authority	105,521,213	25,444,827	94,814,671			14,738,285	14,738,285
Capital Fund	86,683	9,443	1,158,117			1,080,877	1,080,877
Development Fund	59,692	1,394	2,844,668			2,786,370	2,786,370
Tourism Development Fund	16,201,759	9,730,721	10,124,294			3,653,256	3,653,256
Public Finance Corporation	53,240		19,584			(33,656)	(33,656)
Other nonmajor	107,944	-	5,051	-	-	(102,893)	(102,893)
Total business-type activities	809,810,158	44,204,230	406,604,007	-	-	(359,001,921)	(359,001,921)
Total	$ 1,085,461,866	$ 44,204,230	$ 422,111,957	$ 265,171,382	5,027,624	(359,001,921)	(353,974,297)
Transfers-net					(16,014,020)	16,014,020	-
Change in net assets					(10,986,396)	(342,987,901)	(353,974,297)
Net assets–beginning of year					17,308,867	2,298,828,486	2,316,137,353
Net assets–end of year					$ 6,322,471	$ 1,955,840,585	$ 1,962,163,056

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
AS OF JUNE 30, 2005

	Affordable Housing Mortgage Subsidy Program- Stage 8	Subsidy Prepayment Refunding Bonds – Debt Service	New Secure Housing Program	Affordable Housing Mortgage Subsidy Program – Stage 9	The Key for Your Home Program	HUD Programs	Other Nonmajor Governmental Funds	Total Governmental Funds
ASSETS								
Due from other funds	$ 18,045,385	$ 462,714	$ 565,707	$ -	$ 10,479,020	$ -	$ 19,677,158	$ 49,229,984
Restricted:								
Cash and due from banks		3,000		4		1,433,369	1,094,111	2,530,484
Deposits placed with banks							4,200,014	4,200,014
Due from federal government			20,450,310				-	20,450,310
Investments and investment contracts	4,004,484	32,187,499		58,433,131			105,670,540	200,295,654
Loans receivable-net				-			6,576,772	6,576,772
Interest and other receivables	20,406	188,737		12,606			887,889	1,109,638
Other assets	1,417	-	-	-	-	-	2,279,031	2,280,448
TOTAL	$ 22,071,692	$ 32,841,950	$ 21,016,017	$ 58,445,741	$ 10,479,020	$ 1,433,369	$ 140,385,515	$ 286,673,304
LIABILITIES								
Accounts payable and accrued liabilities	$ -	$ 79,437	$ 15,572,528	$ -	$ 24,245,000	$ 1,433,369	$ 659,600	$ 41,989,934
Due to other funds		76,686	21,509,336	66,248,964	1,000,839		60,828,663	149,664,488
Deferred revenue	-	-	12,193,033	-	-	-	-	12,193,033
Total liabilities	-	156,123	49,274,897	66,248,964	25,245,839	1,433,369	61,488,263	203,847,455
FUND BALANCES (DEFICIT)								
Reserved for:								
Long-term loans receivable and other assets							8,855,095	8,855,095
Debt service		32,685,827					20,687,910	53,373,737
Unreserved—special revenue funds	22,071,692	-	(28,258,880)	(7,803,223)	(14,766,819)	-	49,354,247	20,597,017
Total fund balances (deficit)	22,071,692	32,685,827	(28,258,880)	(7,803,223)	(14,766,819)	-	78,897,252	82,825,849
TOTAL	$ 22,071,692	$ 32,841,950	$ 21,016,017	$ 58,445,741	$ 10,479,020	$ 1,433,369	$ 140,385,515	$ 286,673,304

Amounts reported for governmental activities in the statement of net assets are different because:	
Total fund balance	$ 82,825,849
Deferred bonds issue costs that are recorded as expenditures in governmental funds, but are capitalized in the government-wide financial statements	395,907
Long-term liabilities, including bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds	(88,409,331)
Accrued interest payable not due and payable in the current period	(682,987)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds	12,193,033
Net assets of governmental activities	$ 6,322,471

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—GOVERNMENTAL FUNDS FOR THE YEAR ENDED JUNE 30, 2005

	Affordable Housing Mortgage Subsidy Program-Stage 8	Subsidy Prepayment Refunding Bonds – Debt Service	New Secure Housing Program	Affordable Housing Mortgage Subsidy Program – Stage 9	The Key for Your Home Program	HUD Programs	Other Nonmajor Governmental Funds	Total Governmental Funds
REVENUES								
Commonwealth appropriations for repayment of bonds and housing assistance programs	$ 44,233,087	$ 31,543,049	$ 4,763,615	$ 30,766,913	$ -	$ -	$ 8,420,837	$ 119,727,501
Intergovernmental – federal government		-	25,506,022			113,823,830		139,329,852
Interest on investments	1,561,321	2,045,096	409	2,489,498	16,986		8,384,658	14,497,968
Interest income on loans, net							730,826	730,826
Net increase (decrease) in fair value of investments	(102,534)				(33,391)		415,081	279,156
Other	-	-	181,195	-	-	-	293,649	474,844
Total revenues	45,691,874	33,588,145	30,451,241	33,256,411	(16,405)	113,823,830	18,245,051	275,040,147
EXPENDITURES								
Current:								
General government	39,000	76,686					1,301,194	1,416,880
Other	9,997	6,500					531,111	547,608
Housing assistance programs	841,184		43,461,285	714,002	98,378,824	113,823,830	3,275,887	260,495,012
Debt service:								
Principal		28,215,000					7,890,000	36,105,000
Interest	793,189	4,618,503	598,461	3,634,610	-	-	2,847,958	12,492,721
Total expenditures	1,683,370	32,916,689	44,059,746	4,348,612	98,378,824	113,823,830	15,846,150	311,057,221
Excess (deficiency) of revenues over (under) expenditures	44,008,504	671,456	(13,608,505)	28,907,799	(98,395,229)	-	2,398,901	(36,017,074)
Other financing sources (uses):								
Transfers in	-				81,811,470		4,987,934	86,799,404
Transfers out	(60,730,032)	-	-	(12,193,033)	-	-	(29,890,359)	(102,813,424)
Total other financing sources (uses)	(60,730,032)	-	-	(12,193,033)	81,811,470	-	(24,902,425)	(16,014,020)
Net change in fund balances	(16,721,528)	671,456	(13,608,505)	16,714,766	(16,583,759)	-	(22,503,524)	(52,031,094)
Fund balances (deficit)–beginning of year	38,793,220	32,014,371	(14,650,375)	(24,517,989)	1,816,940	-	101,400,776	134,856,943
Fund balances (deficit)–end of year	$ 22,071,692	$ 32,685,827	$ (28,258,880)	$ (7,803,223)	$ (14,766,819)	$ -	$ 78,897,252	$ 82,825,849

See accompanying notes to basic financial statements.

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

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES—GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005

Amounts reported for governmental activities in the statement of net assets are different because:	
Net change in fund balances - total governmental funds	$ (52,031,094)
Repayment of the principal of long-term debt consumes the current financial resources of governmental funds.	36,105,000
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.	(682,987)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	5,639,185
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 year.	(16,500)
Change in net assets of governmental activities	$ (10,986,396)

See accompanying notes to basic financial statements

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

BALANCE SHEET - ENTERPRISE FUNDS
AS OF JUNE 30, 2005

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
ASSETS									
Current assets:									
Cash and due from banks	$ 40,524,230	$ 13,214,009	$ -	$ 16,558,128	$ 5,870,718	$ 1,030,465	$ 2,406,106	$ (37,068,065)	$ 42,535,591
Federal funds sold	1,411,000,000								1,411,000,000
Deposits placed with banks	340,000,000	85,500,000			33,498,228			(118,998,228)	340,000,000
Investments and investment contracts	337,759,611	94,980	437,872		41,444,580				379,737,043
Loans receivable–net	1,412,365,799	6,438,271			47,002,752			(83,371,820)	1,382,435,002
Accrued interest receivable	141,932,192	1,600,471	1,013	33,399	1,557,245	1,957	4,601	(3,057,751)	142,073,127
Other current receivables	43,284,255	10,571,464		377	1,442,615		831		55,299,542
Due from Puerto Rico Department of									-
Housing		13,049,826							13,049,826
Other current assets	78,108	111,308			127,589				317,005
Due from (to) governmental funds	101,593,738	(1,159,234)							100,434,504
Restricted:									-
Cash and due from banks		27,847,090						(1,915,982)	25,931,108
Securities purchased under agreements to resell		240,000,000							240,000,000
Deposits placed with banks		261,709,218						(251,209,129)	10,500,089
Investments and investment contracts		293,161,654							293,161,654
Accrued interest receivable	891,063	12,346,019						(8,442,481)	4,794,601
Other current receivables		87,373							87,373
Real estate available for sale		2,134,883							2,134,883
Other current assets	-	7,025,162	-	-	-	-	-	-	7,025,162
Total current assets	3,829,428,996	973,732,494	438,885	16,591,904	130,943,727	1,032,422	2,411,538	(504,063,456)	4,450,516,510
Noncurrent assets:									
Restricted:									
Deposits placed with banks		3,038							3,038
Investments and investment contracts	224,538,463	885,724,097						(227,858,953)	882,403,607
Loans receivable–net		10,327,507							10,327,507
Investments and investment contracts	515,308,703	19,992,330	69,868,435	17,465,629	39,840,537			(101,904,416)	560,571,218
Loans receivable–net	4,103,105,758	143,030,348			174,589,991			(154,249,395)	4,266,476,702
Real estate available for sale	21,753,932	1,804,412							23,558,344
Capital assets	24,656,070	618,433			315		2,363		25,277,181
Other assets	5,453,964	4,132,971	-	-	-	-	-	-	9,586,935
Total noncurrent assets	4,894,816,890	1,065,633,136	69,868,435	17,465,629	214,430,843	-	2,363	(484,012,764)	5,778,204,532
Total assets	$ 8,724,245,886	$ 2,039,365,630	$ 70,307,320	$ 34,057,533	$ 345,374,570	$ 1,032,422	$ 2,413,901	$ (988,076,220)	$ 10,228,721,042

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

BALANCE SHEET - ENTERPRISE FUNDS
AS OF JUNE 30, 2005

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
LIABILITIES									
Current liabilities:									
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:									
Demand	$ 1,719,760,694	$ -	$ -	$ -	$ -	$ -	$ -	$ (45,259,643)	$ 1,674,501,051
Certificates of deposit	3,536,395,125							(370,207,357)	3,166,187,768
Certificates of indebtedness	213,671,703								213,671,703
Securities sold under agreements to repurchase	99,034,000								99,034,000
Commercial paper	1,191,202,415								1,191,202,415
Accrued interest payable	27,928,908	771,582			2,590,828			(11,500,232)	19,791,086
Accounts payable and accrued liabilities	41,077,504	16,282,166	20,697	3,350	5,473,616	2,254	7,710	6,275,596	69,142,893
Notes payable	-	21,474,630	-	-	79,437,481	-	-	(83,371,820)	17,540,291
Total current liabilities payable from unrestricted assets	6,829,070,349	38,528,378	20,697	3,350	87,501,925	2,254	7,710	(504,063,456)	6,451,071,207
Current liabilities payable from restricted assets:									
Securities sold under agreements to repurchase		240,000,000							240,000,000
Accrued interest payable		3,818,315							3,818,315
Accounts payable and accrued liabilities		5,029,986							5,029,986
Bonds payable	-	54,174,868	-	-	-	-	-	-	54,174,868
Total current liabilities	6,829,070,349	341,551,547	20,697	3,350	87,501,925	2,254	7,710	(504,063,456)	6,754,094,376
Noncurrent liabilities:									
Certificates of deposits, principally from the Commonwealth of Puerto Rico and its public entities	259,830,318							(227,858,953)	31,971,365
Certificates of indebtedness	47,384,000								47,384,000
Securities sold under agreements to repurchase	100,000,000								100,000,000
Allowance for losses on guarantees and letters of credit	1,000,000				5,269,360				6,269,360
Accrued liabilities					-		2,111,519		2,111,519
Bonds and notes payable	267,000,000				154,249,395			(154,249,395)	267,000,000
Noncurrent liabilities payable from restricted assets:									
Allowance for losses on mortgage loan insurance		1,311,835							1,311,835
Bonds payable	-	1,164,642,418	-	-	-	-	-	(101,904,416)	1,062,738,002
Total noncurrent liabilities	675,214,318	1,165,954,253	-	-	159,518,755	-	2,111,519	(484,012,764)	1,518,786,081
Total liabilities	7,504,284,667	1,507,505,800	20,697	3,350	247,020,680	2,254	2,119,229	(988,076,220)	8,272,880,457
NET ASSETS									
Invested in capital assets	24,656,070	618,433			315		2,363		25,277,181
Restricted for:									
Mortgage loan insurance		40,383,280							40,383,280
Affordable housing programs		231,005,339							231,005,339
Unrestricted	1,195,305,149	259,852,778	70,286,623	34,054,183	98,353,575	1,030,168	292,309	-	1,659,174,785
Total net assets	1,219,961,219	531,859,830	70,286,623	34,054,183	98,353,890	1,030,168	294,672	-	1,955,840,585
Total liabilities and net assets	$ 8,724,245,886	$ 2,039,365,630	$ 70,307,320	$ 34,057,533	$ 345,374,570	$ 1,032,422	$ 2,413,901	$ (988,076,220)	$ 10,228,721,042

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 ASSETS - ENTERPRISE FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Total
OPERATING REVENUES:								
Investment income:								
Interest income on federal funds sold and securities purchased under agreements to resell	$ 14,329,227	$ 3,523,461	$ -	$ -	$ -	$ -	$ -	$ 17,852,688
Interest income on deposits placed with banks	1,852,010	18,868,254		238,975	1,046,142	19,584	5,051	22,030,016
Interest and dividend income on investment and investment contracts	43,923,733	61,438,728	984,442	3,855,685	1,782,178			111,984,766
Net increase (decrease) in fair value of investments	8,547,378	(2,879,850)	173,675	(1,249,992)	(173,870)	-	-	4,417,341
Total investment income	68,652,348	80,950,593	1,158,117	2,844,668	2,654,450	19,584	5,051	156,284,811
Loans receivable:								
Public sector	226,758,041							226,758,041
Private sector	2,227,233	13,864,078	-	-	7,469,844	-	-	23,561,155
Total interest income on loans	228,985,274	13,864,078	-	-	7,469,844	-	-	250,319,196
Total investment income and interest income on loans	297,637,622	94,814,671	1,158,117	2,844,668	10,124,294	19,584	5,051	406,604,007
Noninterest income:								
Fiscal agency fees	4,199,269	704,389						4,903,658
Commitment, guarantee and other service fees	3,374,624	8,336,099			4,448,064			16,158,787
Mortgage loan insurance premiums		2,617,379						2,617,379
Net gain on sale of foreclosed real estate available for sale		1,446,978			2,282,611			3,729,589
Gain on sale of loans		7,139,753						7,139,753
Other income	1,443,952	5,200,229	9,443	1,394	3,000,046	-	-	9,655,064
Total noninterest income	9,017,845	25,444,827	9,443	1,394	9,730,721	-	-	44,204,230
Total operating revenues	306,655,467	120,259,498	1,167,560	2,846,062	19,855,015	19,584	5,051	450,808,237
OPERATING EXPENSES:								
Provision (credit) for loan losses	(1,868,258)	3,511,952	-	-	6,510,689	-	-	8,154,383
Interest expense:								
Deposits	113,275,539							113,275,539
Securities sold under agreements to repurchase	174,436	3,657,201						3,831,637
Commercial paper	18,954,948							18,954,948
Certificates of indebtedness	10,669,426							10,669,426
Bonds and notes payable	4,930,106	84,038,819	-	-	8,874,434	-	-	97,843,359
Total interest expense	148,004,455	87,696,020	-	-	8,874,434	-	-	244,574,909
Noninterest expenses:								
Salaries and fringe benefits	25,220,939	9,470,282					68,993	34,760,214
Depreciation and amortization	2,672,479	322,934			1,716			2,997,129
Occupancy and equipment costs	2,960,012	1,059,536			219			4,019,767
Legal and professional fees	2,946,825	2,885,936	86,683	59,108	1,216,301	52,657	30,533	7,278,043
Office and administrative	603,231	3,496						606,727
Subsidy and trustee fees		430,510						430,510
Credit for losses on guarantees and letters of credit					(1,779,790)			(1,779,790)
Other	4,738,749	140,547	-	584	1,378,190	583	8,418	6,267,071
Total noninterest expenses	39,142,235	14,313,241	86,683	59,692	816,636	53,240	107,944	54,579,671
Total operating expenses	185,278,432	105,521,213	86,683	59,692	16,201,759	53,240	107,944	307,308,963
OPERATING INCOME (LOSS)	121,377,035	14,738,285	1,080,877	2,786,370	3,653,256	(33,656)	(102,893)	143,499,274
NONOPERATING EXPENSES:								
Contributions to Special Communities Irrevocable Trust Fund	(500,000,000)							(500,000,000)
Contributions to Cooperative Development Investment Fund and other	(2,501,195)	-	-	-	-	-	-	(2,501,195)
Total nonoperating expenses	(502,501,195)	-	-	-	-	-	-	(502,501,195)
INCOME BEFORE TRANSFERS	(381,124,160)	14,738,285	1,080,877	2,786,370	3,653,256	(33,656)	(102,893)	(359,001,921)
TRANSFER IN		22,074,908						22,074,908
TRANSFER OUT	-	(6,060,888)	-	-	-	-	-	(6,060,888)
CHANGE IN NET ASSETS	(381,124,160)	30,752,305	1,080,877	2,786,370	3,653,256	(33,656)	(102,893)	(342,987,901)
NET ASSETS–Beginning of year	1,601,085,379	501,107,525	69,205,746	31,267,813	94,700,634	1,063,824	397,565	2,298,828,486
NET ASSETS–End of year	$ 1,219,961,219	$ 531,859,830	$ 70,286,623	$ 34,054,183	$ 98,353,890	$ 1,030,168	$ 294,672	$ 1,955,840,585

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
CASH FLOWS FROM OPERATING ACTIVITIES:									
Cash received from interest on housing program loans	$ -	$ 13,790,789	$ -	$ -	$ -	$ -	$ -	$ -	$ 13,790,789
Cash paid for housing program loans originated		(79,111,542)							(79,111,542)
Principal collected on housing program loans		63,762,343							63,762,343
Proceeds from sale of housing program loans		124,276,154							124,276,154
Cash received from insurance premiums		2,617,379							2,617,379
Guarantee fees collected					3,657,198				3,657,198
Cash received from other operating non-interest revenues	60,652,417	13,625,658	9,443	1,394					74,288,912
Cash received from fiscal agency fees	4,199,269	704,389							4,903,658
Due to (from) governmental funds	9,606,066	(657,822)							8,948,244
Cash payments to Commonwealth of Puerto Rico	(8,347,184)								(8,347,184)
Cash payments for other operating non-interest expenses	(8,608,916)	(14,192,805)	(143,427)	(65,831)	(2,957,305)	(62,209)	(19,072)	9,961,932	(16,087,633)
Cash payments for salaries and fringe benefits	(24,766,388)	(7,204,002)	-	-	-	-	(68,993)	-	(32,039,383)
Net cash provided by (used in) operating activities	32,735,264	117,610,541	(133,984)	(64,437)	699,893	(62,209)	(88,065)	9,961,932	160,658,935
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:									
Contributions to others	(502,501,195)								(502,501,195)
Transfer in		22,074,908							22,074,908
Transfer out		(6,060,888)							(6,060,888)
Net increase (decrease) in:									
Deposits	1,157,282,366							(97,581,158)	1,059,701,208
Securities sold under agreements to repurchase	199,034,000	(44,075,703)						44,075,703	199,034,000
Commercial paper	272,500,362								272,500,362
Proceeds from issuance of notes payable		14,376,165						(2,176,165)	12,200,000
Repayments of bonds and notes payable		(143,613,976)			(26,175,173)			26,175,173	(143,613,976)
Payment resulting from settlement and release agreement						(4,748,063)		4,748,063	
Payment of residual amount due to Commonwealth from the liquidation of assets		(50,130)							(50,130)
Interest paid	(136,704,488)	(47,510,840)	-	-	(8,184,671)	-	-	(20,882,407)	(213,282,406)
Net cash provided by (used in) noncapital financing activities	989,611,045	(204,860,464)	-	-	(34,359,844)	(4,748,063)	-	(45,640,791)	700,001,883
NET CASH FLOWS USED IN CAPITAL AND RELATED FINANCING ACTIVITIES—Purchases of capital assets	(13,026,777)	(45,543)	-	-	-	-	-	-	(13,072,320)

See accompanying notes to basic financial statements

(Continued)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
CASH FLOWS FROM INVESTING ACTIVITIES:									
Net decrease (increase) in:									
Federal funds sold and securities purchased under agreements to resell	$ (522,997,297)	$ -	$ -	$ -	$ -	$ -	$ -	$ (44,075,703)	$ (567,073,000)
Deposits placed with banks	(70,000,000)	(92,068,335)			16,140,762			104,127,947	(41,799,626)
Purchases of investment securities	(728,529,990)	(207,438,748)	(975,479)	(100,000)	(38,002,601)			101,082,494	(873,964,324)
Proceeds from redemptions of investments	1,580,214,325	300,291,901	125,689		20,548,453			(87,273,844)	1,813,906,524
Interest and dividends received on investments	49,112,196	75,234,959	983,774	4,065,965	2,390,210	18,972	968	13,154,679	144,961,723
Interest received on other than housing program loans	215,645,806				6,925,684			839,745	223,411,235
Origination of other than housing program loans	(6,801,909,935)				(10,454,889)			2,176,165	(6,810,188,659)
Principal collected on other than housing program loans	5,266,005,950				829,611			(26,175,173)	5,240,660,388
Net change in other assets		7,105,506							7,105,506
Net proceeds and other cash collected related to foreclosed real estate held for sale	-	2,513,163	-	-	27,307,853	-	-	-	29,821,016
Net cash provided by (used in) investing activities	(1,012,458,945)	85,638,446	133,984	3,965,965	25,685,083	18,972	968	63,856,310	(833,159,217)
NET CHANGE IN CASH	(3,139,413)	(1,657,020)		3,901,528	(7,974,868)	(4,791,300)	(87,097)	28,177,451	14,429,281
CASH—At beginning of year	43,663,643	42,718,119	-	12,656,600	13,845,586	5,821,765	2,493,203	(67,161,498)	54,037,418
CASH—At end of year	$ 40,524,230	$ 41,061,099	$	$ 16,558,128	$ 5,870,718	$ 1,030,465	$ 2,406,106	$ (38,984,047)	$ 68,466,699
RECONCILIATION TO ENTERPRISE FUNDS BALANCE SHEET:									
Cash–unrestricted	$ 40,524,230	$ 13,214,009	$ -	$ 16,558,128	$ 5,870,718	$ 1,030,465	$ 2,406,106	$ (37,068,065)	$ 42,535,591
Cash–restricted	-	27,847,090	-	-	-	-	-	(1,915,982)	25,931,108
TOTAL CASH AT YEAR-END	$ 40,524,230	$ 41,061,099	$ -	$ 16,558,128	$ 5,870,718	$ 1,030,465	$ 2,406,106	$ (38,984,047)	$ 68,466,699

See accompanying notes to basic financial statements

(Continued)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:									
Operating income	$ 121,377,035	$ 14,738,285	$ 1,080,877	$ 2,786,370	$ 3,653,256	$ (33,656)	$ (102,893)	$	$ 143,499,274
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:									
Investment income	(60,104,970)	(83,830,443)	(984,442)	(4,094,660)	(2,828,320)	(19,584)	(5,051)		(151,867,470)
Interest income on other than housing program loans	(228,985,274)				(7,469,844)				(236,455,118)
Interest expense	148,004,455	87,696,020			8,874,434				244,574,909
Provision (credit) for loan losses	(1,868,258)	3,511,952			6,510,689				8,154,383
Credit for losses on guarantees and letters of credit					(1,779,790)				(1,779,790)
Deficiency guarantee earned					(3,000,000)				(3,000,000)
Credit for estimated liability for mortgage insurance losses		(878,071)							(878,071)
Net decrease (increase) in fair value of investment	(8,547,378)	2,879,850	(173,675)	1,249,992	173,870				(4,417,341)
Net gain on sales of real estate available for sale		(1,446,978)			(2,282,611)				(3,729,589)
Net gain on sales of loans		(7,139,753)							(7,139,753)
Loss on disposition of capital assets		1,690							1,690
Depreciation and amortization	2,672,479	322,934			1,716				2,997,129
Changes in operating assets and liabilities:									
Housing program loans receivable		108,926,955							108,926,955
Interest receivable on housing program loans		(73,289)							(73,289)
Decrease (increase) in other assets	55,833,841	78,555			(456,087)		(831)		55,455,478
Decrease in due from governmental funds	9,606,066	(657,822)							8,948,244
Decrease in due to Commonwealth of Puerto Rico	(8,347,184)								(8,347,184)
Decrease in estimated liability on mortgage insurance losses		(49,374)							(49,374)
Increase (decrease) in other liabilities	3,094,452	(6,469,970)	(56,744)	(6,139)	(697,420)	(8,969)	20,710	9,961,932	5,837,852
Net cash provided by (used in) operating activities	$ 32,735,264	$ 117,610,541	$ (133,984)	$ (64,437)	$ 699,893	$ (62,209)	$ (88,065)	$ 9,961,932	$ 160,658,935

See accompanying notes to basic financial statements

(Continued)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
NONCASH INVESTING AND NONCAPITAL FINANCING ACTIVITIES:									
Accretion of discount on investment securities and capitalized interest on investment securities	$ 10,666,912	$ 7,609,596	$ -	$ -	$ 325,817	$ -	$ -	$ (7,598,809)	$ 11,003,516
Capitalized interest on loans		630,141							630,141
Transfer of investments between funds		7,834,815							7,834,815
Transfer of allowance for losses on guarantees and letters of credit to allowance for loan losses					1,052,372				1,052,372
Deficiency guarantee earned					3,000,000				3,000,000
Increase of securities purchased under agreements to resell and related liabilities		80,000,000							80,000,000
Accretion of discount on:									
Deposits	7,694,409							(7,598,809)	95,600
Certificate of indebtedness	9,257,190								9,257,190
Commercial paper	292,122								292,122
Bonds payable		36,435,286						(8,029,255)	28,406,031
Increase (decrease) in fair value of investment and derivative financial instruments	8,511,282	(2,879,850)	173,675	(1,249,992)	(173,870)			(8,029,255)	(3,648,010)
Amortization of bond issue cost (included in interest expense)		3,944,769							3,944,769

See accompanying notes to basic financial statements.

(Concluded)

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 for the Commonwealth and its public entities and to make loans to public entities and private enterprises, which will further the economic development of Puerto Rico. 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, except for excise taxes. 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 is authorized to transfer annually to the General Fund of the Commonwealth (the "General Fund") 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 assets of business-type activities for a fiscal year. The Bank's board of directors approved such definition. No transfer was made during the year ended June 30, 2005 because the Bank's business-type activities had a decrease in net assets.

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"), 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 resolutions 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. Financial statements of each major blended component unit may be obtained from the Bank.

The Housing Finance Authority (formerly known as the Puerto Rico Housing Finance Corporation) 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 federally insured mortgage loans on properties located in Puerto Rico and purchased by low- and moderate-income families. The Housing Finance Authority is authorized by the U.S. Department of Housing and Urban Development to administer the U.S. Housing Act Section 8 program in Puerto Rico and to act as an approved mortgagor, both for multifamily rental units and for single-family homes. In addition, it is an 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.

The Housing Finance Authority, in conjunction with the Puerto Rico Department of Housing, is the entity responsible for certifying projects under the New Secure Housing Program (known in Spanish as Nuevo Hogar Seguro), with the approval of the Federal Emergency Management Agency ("FEMA"). This program is directed to plan, coordinate, and develop the construction of new housing as a replacement to those destroyed by Hurricane Georges in 1998, and to attend the housing needs of families living in flood zone areas.

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.

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.

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 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. In January 2002, the Bank's board of directors authorized an increase in the capitalization of the Capital Fund of up to 10% of the net assets of the Bank, as well as the adoption of a new investment strategy, which included the hiring of two additional portfolio managers to diversify the Capital Fund investments in the equity markets. As of June 30, 2005, management, with the consent of the Bank's board of directors, deemed convenient to defer its implementation.

Other 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 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.

To minimize its risk of loss, the Bank purchases insurance coverage for public liability, hazard, automobile, crime, and bonding as well as medical and workmen's insurance for employees. The selection of the insurer has to be approved by the Office of the Commissioner of Insurance of the Commonwealth. Insurance coverage for fiscal year 2005 remained similar to those of prior years. For the last three years insurance settlements have not exceeded the amount of coverage.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Bank conform to U.S. GAAP, as applicable to governmental entities.

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

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 during the reported period. Actual results could differ from those estimates.

Government-wide and Fund Financial Statements

Government-wide Financial Statements—The statement of net assets and the statement of activities report information on all nonfiduciary activities of the Bank. The effect of interfund balances has been removed from the government-wide statement of net assets, except for the residual amounts due between governmental and business-type activities. 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 taxes, 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. Following is a description of the Bank's government-wide financial statements.

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

- Invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of 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 net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on use that are imposed by management, but such constraints may be removed or modified.

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 or for privileges provided, and (2) grants and contributions that are restricted to meeting 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 enterprise funds.

Separate financial statements are provided for governmental funds and enterprise funds. Major individual governmental 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 enterprise funds, each individual blended component unit of the Bank with the exception of JMB Institute and 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 an enterprise fund.

Measurement Focus, Basis of Accounting, and Financial Statements Presentation

***Government-Wide Financial Statement*—**The government-wide 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.

***Governmental Funds' Financial Statements*—**The governmental fund 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 New Secure Housing Program fund. 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. Modifications to the accrual basis of accounting include:

- Employees' vested annual leave is recorded as expenditure when utilized. The amount of accumulated annual leave unpaid at June 30, 2005, has been reported only in the government-wide financial statements.
- Interest on general long-term obligations is generally recognized when paid.
- Debt service principal expenditures and claims and judgments are recorded only when payment is due.

***Governmental Funds*—**The following governmental activities of the Bank are classified as major governmental funds:

- ***Affordable Housing Mortgage Subsidy Program (Stages 8 and 9)*—**These special revenue funds are used to account for the proceeds of specific revenue sources under Stages 8 and 9 of the Affordable Housing Mortgage Subsidy Program ("AHMSP") that are legally restricted to expenditures to promote the origination of mortgage loans by financial institutions in the private sector to low- and moderate-income families. These funds are two of the ten funds that are under the AHMSP of the Authority.

- ***Subsidy Prepayment Refunding Bonds – Debt Service (Act No. 115 Rent Subsidy Fund)—*** This debt service fund is used to account for the Commonwealth appropriations to provide for the payment of principal and interest of certain bonds that were originally issued by a former mortgage subsidy program.
- ***New Secure Housing Program (Nuevo Hogar Seguro)—***This special revenue fund is used to account for federal and local resources directed to plan, coordinate, and develop the construction of new housing as a replacement for those destroyed by Hurricane Georges in 1998 and to attend the housing needs of those families living in flood zone areas.
- ***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.
- ***The Key for Your Home Program—*** It was created to provide subsidy to low- and moderate-income families with costs directly related to the purchase and rehabilitation of housing units.

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

- ***Affordable Housing Mortgage Subsidy Program—***The AHMSP was created to promote the origination of mortgage loans to low- and moderate-income families by financial institutions in the private sector. The program contemplates the issuance of bonds by trust activities of the enterprise funds and the receipt of advances from GDB to provide the funding to promote such loan originations.

  The Housing Finance Authority has a mortgage loan origination and servicing agreement with two major lending institutions in Puerto Rico. Under this agreement both financial institutions agreed to originate $150 million in mortgage loans pursuant to the requirements of the AHMSP within a predetermined schedule of originations. The Authority provides subsidy for the purchase price principal and interest payments on the mortgage loans originated under the agreement. Such loans are insured by the mortgage loan insurance program of the Housing Finance Authority. Loans originated, as well as servicing, are kept by the originating financial institution.

  In addition, the Housing Finance Authority has another mortgage loan origination and servicing agreement, which is similar to the previously described agreement, with various lending institutions in Puerto Rico. Under this agreement, the financial institutions agreed to originate $160 million in mortgage loans pursuant to the requirements of the AHMSP within a predetermined schedule of originations.

- ***Interim Loan Insurance—***Up to June 30, 1989, the Puerto Rico Housing Bank provided an interim loan insurance program created by law to provide mortgage insurance to guarantee the payment of principal and interest on construction loans to developers of low- and moderate-income housing units financed through other financial institutions. Due to the significant claims paid by this program in previous years, it no longer provides insurance coverage and is in the process of liquidating foreclosed real estate. This activity receives legislative appropriations, when needed, to repay the outstanding bond debt and derives its revenue from investment income and sales of the properties acquired through foreclosure.
- ***Special Obligation Refunding Bonds – Debt Service—***This debt service fund accounts for the funds and assets transferred by the Commonwealth through legislative appropriations and liquidator of the former Corporación de Renovación Urbana y Vivienda ("CRUV").

Enterprise Funds' Financial Statements**—**The financial statements of the enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

Enterprise funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses are those that result from the Bank 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 or guarantees and all general and administrative expenses, among other. Revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

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 agency, with whom the agreement is transacted.

Investments and Investment Contracts**—**Investments and investment contracts are carried 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, 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. 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.

Loans Receivable and Allowance for Loan Losses**—**Loans in the enterprise funds are presented at the outstanding unpaid principal balance reduced by any charge-offs and the allowance for loan losses. The accrual of interest on loans to the private sector ceases when loans become past due over six months. For loans to public sector entities, the accrual of interest ceases when management determines that all of the following characteristics are present: (a) a loan is six months past due; (b) it has no current source of repayment; (c) is not covered by a formal commitment from the Commonwealth; and (d) 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.

The allowance for loan losses is established through provisions recorded in the fund financial statements. The allowance is based on management's evaluation of the risk characteristics of the loan 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 collectibility of the principal is unlikely. Recoveries of amounts previously charged off are credited to the respective allowance.

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 allocating a portion of the allowance for loan losses to such loans. If these allocations cause increases to the allowance for loan losses, such increase is reported as provision for loan losses.

Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Interest income and cash receipts on impaired loans are accounted predominantly in the same manner as nonaccrual loans.

Management believes that no losses will be incurred by the Bank with respect to principal and interest on loans to the public sector (including municipalities), and, as a result, such loans are excluded from impairment classification and no allowance for loan losses is generally established for them. For public sector loans, excluding municipalities, management bases its position in that in the past, the Director of the Office of Management and Budget of the Commonwealth ("OMB") has included in the budget of the Commonwealth appropriations to assist certain public sector corporations, agencies, and instrumentalities in repaying their loans with the Bank. The Legislature has generally approved these appropriations, and such practice is anticipated to continue in the future. Further, in accordance with Act No. 164 of December 17, 2001, the Bank is no longer allowed to originate loans without a specific source of repayment being identified beforehand. The Act provides, however, for the Bank to originate new loans up to $100 million without specific sources of repayment with authorization in writing from both the Commonwealth's Governor and the Director of the OMB.

In addition, loans financing the capital improvement programs of certain public corporations are generally bound and subject to repayment from the proceeds of future bonds issuance of these public corporations. The public corporations and the Commonwealth have never defaulted on their respective bonds. Although management of the Bank believes that no losses of principal and interest will be incurred by the Bank with respect to loans to the public sector, there can be no assurance that the Director of the OMB will include in the Commonwealth budget, and that the Legislature will appropriate sufficient funds in the future to cover all amounts due to the Bank by public sector entities requiring such support. Also, the participation of certain public corporations in the bond issuance market has been delayed waiting for the credit standing of the issuer to become more favorable. Because of the relationship among the Bank, the public sector entities, the Director of the OMB, and the Legislature, the timing and amount of any financial assistance and bond proceeds to be provided to certain entities in repaying their loans cannot be reasonably estimated by the Bank, and therefore no allowance has been established in the case of public sector loans for any shortfall between the present value of the expected future cash flows and the recorded investment in the loans.

Loans to municipalities are collateralized by a pledge of a portion of property tax assessments of each municipality. These loans include bonds and notes issued by Puerto Rico municipalities which are acquired by the Bank as bridge financing until such financings can be packaged and securitized. Subsequently, from time to time, the Bank sells, at par, a selection of these bonds and notes to Puerto Rico Municipal Finance Agency ("MFA"), a component unit of the Commonwealth organized to create a capital market to assist municipalities in financing their public improvements programs. These loans, when sold, are pledged to secure the debt service payments for the bonds issued by MFA.

Loans recorded in the governmental funds are presented at the outstanding unpaid principal balance reduced by the allowance for loan losses. A reserve for long-term loans receivable and other assets is recorded within fund balance representing amounts not expected to be collected within the next fiscal year.

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 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 loans in default, determined on the basis of the estimated future net cash outlays in connection with the related guarantees, and a general component for the risk inherent in the other guarantees and letters of credit outstanding, established as a percentage of the principal amount of the underlying loans based on the Bank's loss experience on financial guarantees and management's best judgment.

When a guarantee is executed, 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 possible loan losses. Any deficiency in the estimated allowance requirement is "replenished" through additional provision.

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 the limited historical loss experience and other 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 in the previous year, in connection with obligations guaranteed in excess of fees and charges collected on such guarantees. This legislation currently does not expressly provide for the reimbursement of losses incurred by the Tourism Development Fund on loans made directly by the Tourism Development Fund. The Tourism Development Fund is in the process of submitting an amendment to this legislation to provide for the reimbursement of such losses. The Director of the OMB has to include the amount subject to reimbursement in the General 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. During the year ended June 30, 2003, the Tourism Development Fund initiated a process with the OMB to claim certain reimbursements for disbursements made under the guarantees in excess of fees and charges corresponding to fiscal years 2000 and 2002. Reimbursements from the Commonwealth, if any, are recorded as a receivable to the extent appropriated by the Commonwealth's Legislature. No reimbursements were received nor appropriated in 2005.

Debt Issue Costs**—**Issuance costs are deferred and reported as an asset, and are amortized over the term of the related debt. Issuance costs of bonds accounted for in the governmental funds are recorded as expenditures when paid.

Real Estate Available for Sale**—**Real estate available for sale comprises properties acquired 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 fair value, which is established by a third party professional assessment or based upon an appraisal, minus estimated costs to sell or cost. 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 when it is probable that a loss will be incurred. Results of operations and gain or loss on sale related to foreclosed real estate available for sale are included within other income in the accompanying statement of revenues, expenses, and changes in net assets.

Allowance for losses on Mortgage Loan Insurance**—**The allowance 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 amounts are, in the opinion of management, adequate to cover estimated future normal mortgage loan insurance losses. Actual losses for mortgage loan insurance are charged and recoveries, if any, are credited to the allowance for losses on mortgage loan insurance.

Capital Assets**—**Capital assets, which include premises and equipment, are stated at cost less accumulated depreciation and amortization, and are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the Bank as assets which have a cost of $500 or more at the date of acquisition and have an expected useful life from three or more years. Depreciation is charged to operations and included within other noninterest expense, and is computed on the straight-line basis over the estimated useful lives of the depreciable assets, which have been determined to be from three to five years for furniture and equipment. 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	5-10 years
Information systems	3 years
Office furniture and equipment	5 years
Vehicles	5 years

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.

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 enterprise fund financial statements and the government-wide financial statements present the cost of accumulated vacation and sick leave as a liability. There are no employees paid by governmental funds.

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 collected during the fiscal year or due at June 30 and collected within 120 days. Deferred revenues at the government-wide level arise only when the Bank receives resources before it has a legal claim to them.

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.

No-Commitment 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 no-commitment 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 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 instrumentalities, and public corporations. 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 of the Commonwealth. The underlying notes represent debt of the issuing instrumentalities. The bonds are considered no-commitment debt, and therefore neither the bonds nor the notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements.

Governmental Funds – Reservations of Fund Balance**—**The governmental fund financial statements present reservations of fund balance for portions of fund balances that are legally segregated for a specific future use or are not available for other future spending.

Loan Origination Costs and Commitment Fees**—**Statement of Financial Accounting Standards (SFAS) No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, requires 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 financial position and changes in financial position.

Transfers and Servicing of Financial Assets**—**Transfers and servicing of financial assets and extinguishments of liabilities are accounted and reported based on a consistent application of a financial components approach that focuses on control. This approach distinguishes transfers of financial assets that are sales from transfers that are secured borrowings.

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

Derivative Instruments and Hedging Activities**—**Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Certain Hedging Activities requires that all derivatives must be recorded on the balance sheet (or statement of net assets) at their fair value and that the treatment of changes in the fair value of such instruments depends on the character of the derivative. The Bank partially follows the provisions of SFAS No. 133 as explained in the ensuing paragraphs.

On the date a derivative contract is entered into, the Bank designates the derivative as either a hedge of the fair value of a recognized asset or liability (fair value hedge), or a hedge of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge).

For all fair value hedging relationships, the Bank formally documents the hedging relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives that are designated as fair value to specific assets and liabilities on the balance sheet. The Bank also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value of hedged items. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a fair-value hedge are reflected in the statement of revenues, expenses, and changes in net assets, together with changes in the fair value of the related hedged item. At June 30, 2005, the Bank had no fair value hedging derivatives.

The Bank discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the fair value of the hedged item, the derivative expires or is sold, terminated, or exercised, the derivative is dedesignated as a hedging or management determines that designation of the derivative as a hedging instrument is no longer appropriate. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair value hedge, the Bank continues to carry the derivative on the balance sheet at its fair value and no longer adjusts the hedged asset or liability for changes in fair value. The adjustment of the carrying amount of the hedged asset or liability is accounted for in the same manner as other components of the carrying amount of that asset or liability.

For cash flow hedges, in which derivatives hedge the variability of cash flows related to floating rate assets or liabilities, the accounting treatment under SFAS No. 133 depends on the effectiveness of the hedge. To the extent these derivatives are effective in offsetting the variability of the hedged cash flows, SFAS No. 133 requires that changes in the derivatives' fair value be reported as other changes in equity, also known as other comprehensive income ("OCI"), with these changes in fair value included in earnings of future periods when earnings are also affected by the variability of the hedged cash flows. However, in its guidance for the implementation of GASB Statement No. 34, GASB declared that the concept of OCI was not applicable to governmental entities and further indicated that any amounts which under FASB pronouncements were required to be recorded as changes to OCI should be reported in the statement of revenues, expenses, and changes in net assets under governmental accounting standards. Consequently, the Bank follows the provisions of SFAS No. 133, as modified by such GASB clarification, by recording on the balance sheet or statement of net assets, the fair value of derivatives intended to hedge the variability of cash flows to be received or paid related to a recognized assets or liability, but the change in fair value is reported in the statement of revenues, expenses, and changes in net assets.

Derivative-like instruments embedded in contracts that meet certain criteria prescribed in SFAS No. 133 are separated from their host contract and carried at their fair value, while the host contract is accounted for based on GAAP applicable to instruments of that type that do not contain embedded derivative instruments.

When the Bank enters into a derivative instrument for the purpose of managing its exposure on another freestanding or embedded derivative instrument, the derivative is recorded at its fair value on the balance sheet or statement of net assets and recognizes any changes in fair value in the statement of revenues, expenses, and changes in net assets.

Future Adoption of Accounting Pronouncements—The GASB has issued the following accounting standards that have effective dates after June 30, 2005:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for fiscal years beginning after December 15, 2004.
- GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* which is effective for fiscal years beginning after December 15, 2004.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section—an amendment of NCGA Statement 1*, which is effective for statistical sections prepared for periods beginning after June 15, 2005.
- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions*, which is effective for the Bank for periods beginning after December 15, 2007.
- GASB Statement No. 46, *Net Assets Restricted by Legislation*, which is effective for periods beginning after June 15, 2005.

The impact of these statements on the Bank's basic financial statements has not yet been determined.

3. CASH AND DUE FROM BANKS, FEDERAL FUNDS SOLD, DEPOSITS PLACED WITH BANKS, AND SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

The table presented below discloses the level of custodial credit risk assumed by the Bank at June 30, 2005. 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' policies for deposits placed with banks, federal funds sold and securities purchased under agreements to resell 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 mature as follows: $50 million on July 1, 2005, $290 million on July 5, 2005, and $14.7 million on September 6, 2005. Federal funds sold mature overnight and no collateral is required. As of June 30, 2005, $1,766,872,576 of the depository bank balance of $1,779,371,273 was uninsured and uncollateralized as follows:

	Carrying Amount	Depository Bank Balance	Amount Uninsured and Uncollateralized
Cash and due from banks	$ 70,997,183	$ 13,668,132	$ 1,672,562
Deposits placed with banks	354,703,141	354,703,141	354,200,014
Federal funds sold	1,411,000,000	1,411,000,000	1,411,000,000
Total	$ 1,836,700,324	$ 1,779,371,273	$ 1,766,872,576

Reconciliation to the government-wide statement of net assets:

Unrestricted:	
Cash and due from banks	$ 42,535,591
Deposits placed with banks	340,000,000
Federal funds sold	1,411,000,000
Total unrestricted	1,793,535,591
Restricted:	
Cash and due from banks	28,461,592
Deposits placed with banks	14,703,141
Total restricted	43,164,733
Total	$1,836,700,324

The reported amount and the fair value of securities purchased under agreements to resell at June 30, 2005 amounted to $240 million. At June 30, 2005, these agreements mature within one month. The average amount outstanding during the year amounted to approximately $148 million with the largest amount outstanding at any month-end amounting to approximately $240 million. The Bank's investment policies establish minimum amounts of acceptable collateral, as well as the price of the securities in collateral. The market prices of the collateral are revised monthly and the margin amount adjusted accordingly.

The outstanding balance of securities purchased under agreements to resell at June 30, 2005 is part of the Housing Finance Authority's arbitrage activities, as permitted by law. As part of these activities, the Housing Finance Authority enters into securities purchased under agreements to resell, which are immediately sold under agreements to repurchase to the same counterparties in order to generate an interest rate spread, see Note 9. Accordingly, at June 30, 2005, all of the securities purchased under agreements to resell were held by the counterparties.

4. INVESTMENTS

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

- U.S. government and agencies obligations
- Certificates and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth of Puerto Rico, its agencies, municipalities, public corporations, and instrumentalities
- Federal funds sold
- Securities purchased under agreements to resell
- World Bank securities
- Mortgage- 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 AAA by Moody's

The Bank's investment policies establish limitations and other guidelines on 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 investment committee and the board of directors of the Bank will determine, from time to time, other transactions that the Bank may enter into.

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 Fitch Ratings or Moody's Investors Service, depending on the type and maturity of the investment and the counterparty to the transaction. The investment policies also provide that purchases and sales of investment securities shall be made using the delivery vs. payment procedures.

The Bank's investment policies also provide that the Asset Liability Management Committee (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 and management.

The following table summarizes the type and maturities of investments held by the Bank at June 30, 2005. 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 from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment Type	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	Total
U.S. Treasury bills	$ 19,874,031	$ 46,670	$ -	$ -	$ 19,920,701
U.S. Treasury notes	13,222,219				13,222,219
U.S. sponsored agencies notes:					
Federal Home Loan Bank (FHLB)	5,968,140	283,502,775	74,325,000		363,795,915
Federal Home Loan Mortgage Corporation (FHLMC)	99,824,308				99,824,308
Federal Farm Credit Bank (FFCB)	10,905,400				10,905,400
Federal National Mortgage Association (FNMA)	7,955,100				7,955,100
Mortgage and asset -backed securities:					
Government National Mortgage Association (GNMA)		241,578	14,711,754	513,571,319	528,524,651
FNMA	152,943	1,521,580	4,948,744	39,424,120	46,047,387
FHLMC	176,104	1,497,092	14,923,576	27,024,461	43,621,233
Other	567,803	6,817,070	1,502,988	1,207,134	10,094,995
Corporate debt:					
Popular NA		60,335,850			60,335,850
Other		7,883,780			7,883,780
External investment pools - Fixed-income securities	35,338,215				35,338,215
Nonparticipating investment contracts:					
CDC Funding	285,640,596			52,418,767	338,059,363
American International Group		94,878,246		134,093,370	228,971,616
Banco Popular de Puerto Rico	200,000,000			18,873,208	218,873,208
Other	68,021	41,068,000	675	153,677,012	194,813,708
Total investments	$ 679,692,880	$ 497,792,641	$ 110,412,737	$ 940,289,391	2,228,187,649
External investment pools - Equity securities:					
Russell 1000 Growth Common Trust Fund					69,868,435
Guayacan Private Equity Fund					15,605,219
Venture Capital Fund, Inc.					1,755,376
Other					105,034
Equity securities					647,463
Total					$ 2,316,169,176

Reconciliation to the government-wide statement of net assets	
Unrestricted investments	$ 940,308,261
Restricted investment	1,375,860,915
Total	$2,316,169,176

Investments in fixed-income external investment pools had an average maturity of less than 60 days; accordingly, they were presented as investments with maturity of less than one year. These investments include $24,907,692 invested with 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.

At June 30, 2005, $332,933,125 of the Bank's investments in U.S. sponsored agencies notes maturing over one year of $357,827,775 bear a variable interest rate resetting either monthly or quarterly at 100% of an interest rate index plus or minus a spread. In addition, at June 30, 2005, $50,090,850 of the Bank's investment in corporate debt maturing over one year of $68,219,630 bear a variable interest rate resetting quarterly at 100% of an interest rate index plus or minus a spread. Also at June 30, 2005, approximately 96% 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 provide for early redemption of the bonds if the securities are early repaid.

All of the Bank's investments in U.S. Treasury securities and mortgage-backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government. The credit quality ratings for investments in debt securities, excluding U.S. Treasury securities and mortgage-backed securities guaranteed by GNMA, at June 30, 2005 are as follows:

	Credit Risk			
	Rating			
Securities type	**AAA to A**	**BBB+**	**Not Rated**	**Total**
U.S. sponsored agencies notes:				
Federal Home Loan Bank (FHLB)	$ 363,795,915	$ -	$ -	$ 363,795,915
Federal Home Loan Mortgage Corporation (FHLMC)	99,824,308			99,824,308
Federal Farm Credit Bank (FFCB)	10,905,400			10,905,400
Federal National Mortgage Association (FNMA)	7,955,100			7,955,100
Mortgage and asset -backed securities:				
FNMA	46,047,387			46,047,387
FHLMC	43,621,233			43,621,233
Other	10,094,995			10,094,995
Corporate debt	7,883,780	60,335,850		68,219,630
External investment pools - Fixed-income securities	34,900,343		437,872	35,338,215
Nonparticipating investment contracts	761,844,657	218,873,208	-	980,717,865
Total	$ 1,386,873,118	$ 279,209,058	$ 437,872	$ 1,666,520,048

The credit quality ratings for nonparticipating investment contracts are based on the credit quality ratings 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, 2005, 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	$ 1,194,082,870
Securities sold under agreements to repurchase	199,034,000
Certificates of indebtedness	62,484,000

5. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans at June 30, 2005 consist of the outstanding balance of credit facilities granted to the following (in thousands):

		Enterprise funds			
	Governmental Activities	GDB Operating Fund	Tourism Development Fund	Housing Finance Authority	Total
Public corporations and agencies	$ -	$ 4,497,881	$ -	$ -	$ 4,497,881
Municipalities	-	743,341	-	-	743,341
Total loans to public sector	-	5,241,222	-	-	5,241,222
Private sector	6,888	38,808	253,141	181,520	480,357
Allowance for loan losses	(311)	(2,180)	(31,548)	(21,724)	(55,763)
Total	6,577	36,628	221,593	159,796	424,594
Balance–end of year	$ 6,577	$ 5,277,850	$221,593	$159,796	$ 5,665,816

Reconciliation to the government-wide statement of net assets:	
Unrestricted loans receivable–net	$ 5,648,912
Restricted loans receivable–net	
Governmental activities	6,577
Business-type activities	10,327
Total	$ 5,665,816

Public sector loans amounting to approximately $227.7 million as of June 30, 2005 were delinquent by 90 days or more. This balance includes approximately $16.9 million of loans classified as non-accrual. Interest income that would have been recorded if these loans had been accruing in accordance with their original terms was approximately $1.5 million in 2005. Public sector loans classified as non-accrual amounting to $27.9 million at the beginning of year were fully collected, including interest in the amount of $8.8 million.

Loans to the private sector include the outstanding principal balance of credit facilities granted by the Bank to private enterprises in Puerto Rico, the activities of which are deemed to further the economic development of Puerto Rico. They 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 multifamily housing units in Puerto Rico, and direct loans to tourism projects. These credit facilities amounted to $424.6 million at June 30, 2005 of which $166.4 million are mortgage loans for low- and moderate-income housing units and $221.6 are for tourism projects.

Private sector loans classified as non-accrual amounted to approximately $114.7 million at June 30, 2005. Interest income that would have been recorded if these loans had been performing in accordance with their original terms was approximately $6.5 million in 2005. Interest collected on these loans amounted to approximately $9 million for the year ended June 30, 2005.

The following is a summary of private sector loans of the enterprise funds considered to be impaired as of June 30, 2005, and the related interest income for the year then ended (in thousands):

	Enterprise funds			
	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Total
Recorded investment in impaired loans:				
Not requiring an allowance for loan losses	$1,596	$ -	$ -	$ 1,596
Requiring an allowance for loan losses	-	57,583	75,590	133,173
Total recorded investment in impaired loans	$1,596	$57,583	$75,590	$134,769
Related allowance for loan losses	$ -	$ 6,750	$28,587	$ 35,337
Average recorded investment in impaired loans	1,654	55,896	75,590	133,140
Interest income recognized on impaired loans	35	-	-	35

The following is a summary of the activity in the allowance for loan losses for the year ended June 30, 2005 (in thousands):

		Enterprise Funds			
	Governmental Activities	GDB Operating Fund	Tourism Development Fund	Housing Finance Authority	Total
Balance–beginning of year	$9,986	$1,970	$25,037	$18,234	$55,227
Provision for loan losses	(4,343)	(1,868)	6,511	3,512	3,812
Charge-offs	(5,332)	-	-	(22)	(5,354)
Recoveries	-	2,078	-	-	2,078
Balance–end of year	$ 311	$2,180	$31,548	$21,724	$55,763

During the year ended June 30, 2005, the Housing Finance Authority sold approximately $108.1 million and $9.0 million of single-family and multifamily mortgage loans receivable, respectively. The net proceeds from the sale of these loans amounted to approximately $115.6 million, including $485,000 of accrued interest, for single-family mortgage loans and $9.7 million, including $531,980 of accrued interest, for multifamily mortgage loans. The net gains from the single family and multifamily loans sales were approximately $6,974,000 and $166,000, respectively.

6. DUE FROM FEDERAL GOVERNMENT AND PUERTO RICO DEPARTMENT OF HOUSING

The amount due from the federal government amounting to $20,450,310 at June 30, 2005 consists of the reimbursable share from FEMA of eligible costs incurred to plan, coordinate, and develop the construction of new housing as a replacement for those destroyed by Hurricane Georges in 1998 and to attend the housing needs of certain families living in flood zone areas in Puerto Rico. Amounts collected are subject to compliance audits under OMB Circular A-133 and federal granting agencies auditors. Management believes that it has complied with the terms of the grant and that all amounts claimed will be collected and, therefore, no allowance for uncollectible accounts has been established.

The amount due from the Puerto Rico Department of Housing of $13,049,826 at June 30, 2005, including accrued interest, consists of advances under four lines of credit. The approved amounts under these lines of credit are $3.2 million, $4 million, $10 million, and $50 million. Management believes that the total balance due from the Puerto Rico Department of Housing is collectible; therefore, no allowance for doubtful accounts was recorded in the accompanying basic financial statements at June 30, 2005. As of June 30, 2005, the Authority maintained a line of credit of $50 million with a commercial bank to finance the operations of the project "Revitalización de Santurce," which balance is of approximately $5,840,000. In connection with this project the Housing Finance Authority has properties held in trust amounting to $8,880,000 received from Puerto Rico Department of Housing, included in other assets in the accompanying statement of net assets, and used to secure the line of credit outstanding balance.

7. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2005, was as follows:

	Beginning Balance	Additions	Reductions/ Reclassifications	Ending Balance
Capital assets not being depreciated:				
Land	$ 2,955,000	$ -	$ (110,000)	$ 2,845,000
Construction in progress	-	5,450,134	4,303,080	9,753,214
Total capital assets not being depreciated	2,955,000	5,450,134	4,193,080	12,598,214
Capital assets being depreciated:				
Building	8,988,048	-	-	8,988,048
Leasehold improvements	1,283,538	7,600	(831,874)	459,264
Information systems	3,565,020	1,658,254	(555,781)	4,667,493
Office furniture and equipment	3,381,952	85,101	(408,716)	3,058,337
Software	4,921,753	1,822,029	(4,467,564)	2,276,218
Vehicles	439,096	67,088	-	506,184
Total capital assets being depreciated	22,579,407	3,640,072	(6,263,935)	19,955,544
Less accumulated depreciation and amortization for:				
Building	(786,454)	(224,701)	-	(1,011,155)
Leasehold improvements	(875,623)	(117,925)	828,439	(165,109)
Information systems	(2,716,637)	(802,544)	47,130	(3,472,051)
Office furniture and equipment	(1,590,435)	(378,444)	13,349	(1,955,530)
Software	(4,109,476)	(1,420,576)	5,162,360	(367,692)
Vehicles	(252,101)	(52,939)	-	(305,040)
Total accumulated depreciation and amortization	(10,330,726)	(2,997,129)	6,051,278	(7,276,577)
Total capital assets being depreciated–net	12,248,681	642,943	(212,657)	12,678,967
Total capital assets–net	$15,203,681	$ 6,093,077	$ 3,980,423	$25,277,181

Construction in progress represents costs incurred up to June 30, 2005 for the new headquarters of the Bank. These headquarters are being constructed in parcels of land currently owned by another agency of the Commonwealth. In January 2004, the Bank entered into an agreement with such agency whereby the Bank will transfer a property currently owned by the Bank with a similar fair value, recorded as part of real estate owned available for sale, in exchange for the parcels of land owned by the agency. Management of the Bank expects to complete the transfer during 2006.

8. 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 $113.3 million in 2005.

9. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Housing Finance Authority was designated by the Office of the Commissioner of Financial Institutions of the Commonwealth (the "Commissioner") as an eligible similar institution under Puerto Rico Regulation 5105. This regulation allows the Authority to receive up to $250 million in eligible funds (commonly known as 936 tax-exempt funds), which are received through securities sold under agreements to repurchase and used for an arbitrage program.

The maturities of the investments made with proceeds obtained from the securities sold under agreements to repurchase are matched with the maturities of such obligations. As of June 30, 2005, $240,000,000 have been received and invested in repurchase agreements. The repurchase agreements are used to collateralize the securities sold under agreements to repurchase. As of June 30, 2005, the aggregate market value plus accrued interest of the underlying securities exceeded the securities sold under agreements to repurchase, including accrued interest.

The program requires that net interest income generated by the investment of such funds must be used only for the following purposes:

- At least 50% shall be used to partially subsidize origination costs on mortgage loans to low- and moderate-income families.
- Strengthen the accrual for estimated mortgage loan insurance losses. The purpose of such strengthening is to increase the amount of mortgage loans insured by the fund. During the year, no transfers to the mortgage loan insurance fund for the above purpose were made.
- Subsidize the sale of mortgages with discounts.
- Provide for expenses related to the administration of these funds.

During the year ended June 30, 2005, this program generated a net interest income of $45,508.

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

Carrying amount at June 30, 2005	$ 439,034,000
Maximum amount outstanding at any month-end	439,034,000
Average amount outstanding during the year	150,688,153
Weighted average interest rate for the year	2.80%
Weighted average interest rate at year-end	3.08%

The following summarizes the activity of securities sold under agreements to repurchase for the year ended June 30, 2005:

	Beginning Balance	Issuances	Maturities	Ending Balance
GDB Operating Fund	$ -	$ 199,034,000	$ -	$ 199,034,000
Housing Finance Authority	160,000,000	2,129,034,000	1,850,000,000	240,000,000
Total	$ 160,000,000	$ 2,328,068,000	$ 1,850,000,000	$ 439,034,000

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, 2005, securities sold under agreements to repurchase mature as follows: $339,034,000 within one month and $100 million within five years.

10. COMMERCIAL PAPER

The Bank issues commercial paper in the U.S. taxable and tax-exempt commercial paper markets, in the Eurodollar commercial paper market, and to corporations that have grants of tax exemption under the Commonwealth's industrial incentives laws and that qualify for the benefits provided under Section 936 of the U.S. Internal Revenue Code. Commercial paper represents unsecured obligations of the Bank.

The following information corresponds to commercial paper:

Carrying amount at June 30, 2005	$1,191,202,415
Maximum amount outstanding at any month-end	1,191,202,415
Average amount outstanding during the year	973,560,290
Weighted average interest rate for the year	1.97%
Weighted average interest rate at year-end	2.98%

The following summarizes the commercial paper activity for fiscal year 2005:

	Beginning Balance	Issuances	Net Increase of Discount	Maturities	Ending Balance	Due Within One Year
GDB Operating Fund	$ 918,409,931	$ 7,564,911,566	$ (8,529)	$ 7,292,110,553	$ 1,191,202,415	$ 1,191,202,415

11. CERTIFICATES OF INDEBTEDNESS

Certificates of indebtedness consist of time deposits from corporations that have grants of tax exemptions under the Commonwealth's industrial incentives laws and that qualify for the benefits provided under Section 936 of the U. S. Internal Revenue Code. The following summarizes the certificates of indebtedness activity for the year ended June 30, 2005:

	Beginning Balance	Issuances	Discount Accretion	Maturities	Ending Balance	Due Within One Year
GDB Operating Fund	$ 251,798,513	$ -	$ 9,257,190	$ -	$ 261,055,703	$ 213,671,703

At June 30, 2005, the scheduled maturities of certificates of indebtedness are as follows:

Year Ending June 30	
2006	$213,671,703
2007	47,384,000
Total	$261,055,703

At June 30, 2005, the Bank had a deposit from Microsoft Puerto Rico, Inc. for $200 million. Interest on this deposit is based on the market price appreciation, if any, of the shares of common stock of Microsoft Corporation. The Bank has entered into an interest rate swap agreement whereby it will receive such market price appreciation and pays a fixed interest to manage such risk.

12. BONDS AND NOTES PAYABLE AND OTHER LIABILITIES

The activity of bonds payable and other borrowed funds for the year ended June 30, 2005 is as follows:

	Beginning Balance	Debt Issued	Debt Paid	Reductions	Ending Balance	Due Within One Year
Governmental activities:						
Commonwealth appropriation bonds and notes:						
Law 115 – Subsidy prepayment refunding bonds	$ 89,210,000	$ -	$ (28,215,000)	$ -	$ 60,995,000	$ 28,595,000
Note payable – Affordable Housing Mortgage Subsidy Program Stage 7	10,339,331	-	-	-	10,339,331	95,748
Total Commonwealth appropriation bonds and notes	99,549,331	-	(28,215,000)	-	71,334,331	28,690,748
General obligation bonds:						
Loan insurance claims refunding bonds	24,965,000	-	(7,890,000)	-	17,075,000	7,825,000
Total governmental activities	$ 124,514,331	$ -	$ (36,105,000)	$ -	$ 88,409,331	$ 36,515,748

	Beginning Balance	Issuances, Net	Reductions	Ending Balance	Due within One Year
Business-type activities:					
GDB Operating Fund—Adjustable Refunding Bonds	$ 267,000,000	$ -	$ -	$ 267,000,000	$ -
Housing Finance Authority:					
Mortgage Trust III	1,164,063,874	-	(43,540,000)	1,120,523,874	43,310,000
Revenue bonds:					
Collateralized Mortgage Revenue Bonds	71,950,000	-	(10,275,000)	61,675,000	1,338,000
Single Family Mortgage Revenue Bonds – Portfolio I	43,375,000	-	(715,000)	42,660,000	830,000
Single Family Mortgage Revenue Bonds – Portfolio II (net of elimination of $4,535,000)	9,350,000		(2,850,000)	6,500,000	-
Single Family Mortgage Revenue Bonds – Portfolio III	20,720,000	-	(16,690,000)	4,030,000	22,000
Single Family Mortgage Revenue Bonds, Stage IX-2002	350,000,000		(2,675,000)	347,325,000	5,475,000
Single Family Mortgage Revenue Bonds – Portfolio IV	60,564,000	-	(901,000)	59,663,000	957,000
Mortgage Trust IV:					
Collateralized mortgage obligations	50,750,895	-	(25,651,180)	25,099,715	-
Homeownership Mortgage Revenue Bonds 200(	89,000,000	-	(13,180,000)	75,820,000	1,423,000
Homeownership Mortgage Revenue Bonds 2001	89,330,000	-	(9,500,000)	79,830,000	1,015,000
Homeownership Mortgage Revenue Bonds 200:	43,575,000	-	(8,060,000)	35,515,000	655,000
Total revenue bonds	828,614,895	-	(90,497,180)	738,117,715	11,715,000
Subtotal Housing Finance Authority	1,992,678,769	-	(134,037,180)	1,858,641,589	55,025,000
Notes payable (operations and administration)	16,675,261	14,376,165	(9,576,796)	21,474,630	21,474,630
Less unaccreted discount	676,259,589	-	(36,435,286)	639,824,303	850,132
Total Housing Finance Authority	1,333,094,441	14,376,165	(107,178,690)	1,240,291,916	75,649,498
Tourism Development Fund notes payable to GDB	259,862,049	-	(26,175,173)	233,686,876	79,437,481
Total	1,859,956,490	14,376,165	(133,353,863)	1,740,978,792	155,086,979
Less intrafund elimination	(355,495,382)	(2,176,165)	18,145,916	(339,525,631)	(83,371,820)
Total business-type activities	$1,504,461,108	$12,200,000	$(115,207,947)	$1,401,453,161	$ 71,715,159

The annual debt service requirements to maturity, including principal and interest, for long-term debt as of June 30, 2005, are as follows:

Year Ending June 30	GDB Operating Fund Business-Type Activities Principal	Interest
2006	$ -	$ 5,713,800
2007	-	5,713,800
2008	-	5,713,800
2009	-	5,713,800
2010	-	5,713,800
2011-2015	-	28,569,000
2016	267,000,000	2,380,750
Total	$267,000,000	$59,518,750

	Housing Finance Authority			
Year Ending	Governmental Activities		Business-type Activities	
June 30	Principal	Interest	Principal	Interest
2006	$ 36,515,748	$ 3,977,819	$ 55,025,000	$ 40,309,248
2007	41,695,048	1,785,564	55,919,000	39,796,382
2008	38,504	569,260	56,819,000	39,214,969
2009	150,768	562,122	57,629,000	38,566,125
2010	159,040	553,775	57,940,000	37,862,403
2011-2015	888,556	2,553,628	313,768,715	176,121,975
2016-2020	1,392,014	2,067,885	282,340,000	140,943,289
2021-2025	1,867,429	1,546,876	176,671,000	102,965,753
2026-2030	3,545,142	920,144	681,473,874	58,262,574
2031-2035	2,157,082	83,354	121,056,000	14,016,952
Total	$ 88,409,331	$ 14,620,427	$ 1,858,641,589	$ 688,059,670

Governmental Activities

Bonds and notes payable by governmental activities consist of the following:

Description and Maturity Date	Interest Rate	Amount Outstanding
Commonwealth appropriation bonds and notes:		
Subsidy Prepayment Refunding Bonds:		
December 1, 2002 and each December 1 thereafter to December 1, 2006	5.125%-7.50%	$ 60,995,000
Loan Insurance Claims Refunding Bonds:		
December 1, 2002 and each December 1 thereafter to December 1, 2006	5.125%-5.25%	17,075,000
Note payable Affordable Housing Mortgage Subsidy Program Stage 7:		
July 1, 2005 and each July 1 thereafter to July 1, 2031	4.10%-5.25%	10,339,331
Total governmental activities bonds and notes payable		$88,409,331

Subsidy Prepayment Refunding Bonds and Loan Insurance Claims Refunding Bonds—The principal and interest of the Subsidy Prepayment and Loan Insurance Claims Refunding Bonds are payable from and secured by amounts appropriated by the Legislature of the Commonwealth and paid by the Secretary of the Treasury for such purpose; and a pledge and assignment of all rights, title, and interest of the Authority in and to all moneys and securities in the funds and accounts established under the Subsidy Prepayment and Insurance Claims Refunding Indentures.

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 Affordable Housing Mortgage Subsidy Program Stage 7 note payable (the "Old Note") of the Housing Bank, as authorized by Act No. 164 of December 17, 2001. The Public Finance Corporation acquired and restructured the Note through the issuance of its Commonwealth appropriations bonds ("PFC Bonds"). The PFC Bonds were issued under a trust indenture whereby the Public Finance Corporation pledged and sold 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. The notes payable to the Public Finance Corporation were originally composed of a loan granted by the Bank, which, pursuant to Act No. 164 of December 17, 2001, the Public Finance Corporation acquired and restructured through the issuance of Commonwealth appropriation bonds. These bonds were issued under trust indenture agreements whereby the Public Finance Corporation pledged the notes to certain trustees and created a first lien on the pledged revenue (consisting of annual 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 recognizes a mirror effect of this advance refunding by the Public Finance Corporation in its own notes payable in proportion to the portion of the Housing Finance Authority's notes 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. At June 30, 2005, approximately $4.1 million of the notes refunded during June 2004 remain outstanding and are considered defeased.

The amount outstanding of the Note at June 30, 2005 was $10,339,331 and matures on July 1, 2031. Interest on the unpaid principal amount of the Note is equal to the applicable percentage of the aggregate interest payable on the Public Finance Corporation Bonds. Applicable percentage is the percentage representing the proportion of the amount paid by Public Finance Corporation on the PFC Bonds serviced by the Note to the aggregate amount paid by Public Finance Corporation on all the PFC Bonds issued by Public Finance Corporation under Act No. 164.

Business-Type Activities

Bonds payable by business-type activities consist of the following:

Description and Maturity Date	Interest Rate	Amount Outstanding
Adjustable refunding bonds:	Variable, 2.14%	
December 1, 2015	at June 30, 2005	$ 267,000,000
Mortgage Trust III:		
January 1, 2001 and each July 1 and January 1		
thereafter to July 1, 2011	Zero Coupon	139,751,124
January 1, 2001 and each July 1 and January 1		
thereafter to January 1, 2021	Zero Coupon	239,940,670
Collateralized mortgage revenue bonds:		
January 1, 2005 and every January 1 and July 1		
thereafter to January 1, 2029	6.10%-6.30%	61,675,000
Single family mortgage revenue bonds – Portfolio I:		
October 1, 2002 and each April 1 and October 1		
thereafter to April 1, 2029	5.45%-6.25%	42,660,000
Single family mortgage revenue bonds – Portfolio II:		
June 1, 2007 and every December 1 and June 1		
thereafter to December 1, 2023	7.00%	5,603,361
Single family mortgage revenue bonds – Portfolio III:		
August 1, 2005 and each February and August 1		
thereafter to August 1, 2029	6.20%-7.00%	4,030,000
Single family mortgage revenue bonds – Portfolio IV:		
December 1, 2005 and each June 1 and December 1		
thereafter to December 1, 2030	5.90%-6.25%	59,663,000
Mortgage Trust IV - May 1, 2015	6.00%	25,099,715
Single family mortgage revenue bonds – Portfolio IX:		
June 1, 2005 and each December 1 and June 1 thereafter		
to December 1, 2012	3.10%-5.60%	347,325,000
Homeownership Mortgage Revenue Bonds 2000 Series:		
December 1, 2002 and each June 1 and December 1		
thereafter to December 1, 2032	4.10%-5.20%	75,762,000
December 1, 2033	4.20%	29,000
December 1, 2034	4.20%	29,000
Homeownership Mortgage Revenue Bonds 2001 Series:		
December 1, 2002 and each December 1 thereafter		
to December 1, 2012	3.70%-4.35%	13,125,000
June 1, 2013 and each December 1 and June 1		
thereafter to December 1, 2033	4.45%-5.50%	66,705,000
Homeownership Mortgage Revenue Bonds 2003 Series:		
December 1, 2005 and each December 1 thereafter		
to December 1, 2013	1.75%-4.00%	6,530,000
June 1, 2013 and each December 1 and June 1		
thereafter to December 1, 2033	4.375%-4.875%	28,985,000
Total		$ 1,383,912,870

The Adjustable Refunding Bonds were issued in December 1985. Interest due on these bonds is payable monthly at a rate determined weekly, based on the factor necessary to produce as nearly as practicable a par bid for each bond on the date of determination, but not greater than 12% per annum in any case. The payment of principal and interest on the bonds is secured by a stand-by bond purchase agreement issued by a third party to a trustee. The payment of principal and interest is also guaranteed by the full faith and credit of the Commonwealth and is insured by MBIA Insurance Corporation. The bonds are convertible to a fixed rate commencing on any date at the election of the Bank. Such conversion will subject the bonds to mandatory tender for purchase on the effective date of the conversion to a fixed rate, but holders desiring to keep their bonds after conversion may waive such mandatory tender. Furthermore, as long as interest on the bonds is payable at a variable rate, each bondholder has the option to have any of the bonds purchased in whole or in part, in multiples of $50,000, at par plus interest accrued to the purchase date. Prior to conversion of the bonds to a fixed rate of interest, the bonds are subject to mandatory tender for purchase, at the option of the Bank, on any interest payment date at par, with at least 10 days notice from the trustee.

In December 2002, the Housing Finance Authority entered into a non-revolving credit facility (the "Facility") with a commercial bank in the aggregate principal amount of up to $50 million to provide funds to the Department of Housing for the rehabilitation and redevelopment of the Santurce sector of the Municipality of San Juan (the "Plan"). Under this Plan, approximately 159 properties (the "Target Properties") were identified and are intended to be acquired through purchase or expropriation, for sale to persons that will develop, re-develop, and/or construct, commercial and residential projects. The acquisition and sale of the Target Properties will be undertaken through the Department of Housing under Act No. 201 of the Legislature of the Commonwealth dated August 26, 2002. Therefore, the Department of Housing, not the Housing Finance Authority, will own all the Target Properties acquired under the Plan.

At June 30, 2005, the Facility has an outstanding balance of $5,840,291, maturing in December 2005. The Facility bears a variable interest consisting of the 30-day London Interbank Offered Rate ("LIBOR") plus 0.50% at the first day of each month (3.64% at June 30, 2005). The Housing Finance Authority is obligated, under this credit agreement, to prepay the advances of the Facility upon the sale or disposition of all or any part of the mortgaged Target Properties in the amount of 100% of the net proceeds.

On April 28, 2005, the Housing Finance Authority entered into a new credit facility with another commercial bank to increase the availability of funds to the Puerto Rico Department of Housing. The facility consists of a non-revolving line of credit in an aggregate principal amount not to exceed $12,200,000. Advances made under this line of credit were used to refinance existing loans and to pay costs and expenses related to the transaction. At June 30, 2005, this facility has an outstanding balance of $11,700,000, maturing in April 2007. The facility bears a variable interest consisting of the 30-day LIBOR plus 0.35% at the first day of each month (3.49% at June 30, 2005) and payable quarterly in arrears on the first business day of each quarter (July 1st, October 1st, January 1st and April 1st). This facility is expected to be repaid from assets classified current at June 30, 2005, accordingly, it has been classified as a current liability such date.

The activity for noncurrent accrued liabilities during the year ended June 30, 2005 follows:

Balance–beginning of period	$2,084,612
Additions	26,907
Balance–end of period	$2,111,519

The activity for compensated absences during the year ended June 30, 2005 follows:

	Balance	Provision	Reductions	Balance
Vacation	$ 2,505,379	$ 2,219,716	$ (1,769,518)	$ 2,955,577
Sickness	2,393,392	1,562,484	(1,291,585)	2,664,291
Total	$ 4,898,771	$ 3,782,200	$ (3,061,103)	$ 5,619,868

13. RESTRICTED NET ASSETS—MORTGAGE LOAN INSURANCE FUND

The Housing Finance Authority is required by law to maintain a reserve for losses on insured mortgage loans, which is computed as a percentage of the outstanding principal balance of the insured mortgage loans and is not used to account for gain or losses. Losses incurred upon the foreclosure and subsequent gains or losses on the disposal of properties are credited/charged to the estimated liability for mortgage loan insurance losses. At June 30, 2005, the Housing Finance Authority had restricted net assets for such purposes of approximately $40.4 million.

14. 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 and contributions, 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 statement of net assets and fund balance sheets. 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, 2005, the off-balance-sheet risks consisted of the following (in thousands):

Financial instruments whose credit risk is represented by contractual amounts:	
Financial guarantees to:	
Public sector	$ 75,000
Private sector	79,251
Total	$ 154,251
Standby letters of credit:	
Public sector	$ 80,120
Private sector	165,465
Total	$ 245,585
Commitments to extend credit:	
Public sector	$2,908,021
Private sector	22,123
Total	$2,930,144

Financial guarantees and letters of credit outstanding at June 30, 2005 include approximately $168 million issued by the Tourism Development Fund on several private hotel and tourism development projects.

On July 1, 2002, the Bank issued a payment guarantee in favor of Ondeo de Puerto Rico, Inc. (“Ondeo”) in connection with a service contract for water and wastewater system management between Puerto Rico Aqueduct and Sewer Authority (“PRASA”), a component unit of the Commonwealth, and Ondeo (the “service contract”) whereby the Bank guaranteed to Ondeo the full payment of the annual service fee due to Ondeo by PRASA under the service contract and any termination fee payable pursuant to such service contract. Under the provisions of Article 7 of Act No. 95 of June 30, 2002, any payments made by the Bank under the payment guarantee, up to an amount equal to the annual service fee established under the service contract, are reimbursable annually to the Bank from annual budgetary appropriations made by the Legislature of the Commonwealth.

The service contract between Ondeo and PRASA was cancelled on January 15, 2004. It was agreed, as part of the negotiations, that each party will issue a reciprocating letter of credit, for a maximum of $37.5 million, in exchange for the cancellation of the previous payment guarantee.

On June 22, 2005, PRASA and Ondeo entered into a Claim and Submittal of Letter of Credit Date Waiver whereby PRASA and Ondeo agreed to extend the deadline for the presentation of the pending claims to June 24, 2005 and the deadline for the presentation of the new letters of credit to June 28, 2005.

The Bank issued a letter of credit in favor of Ondeo effective as of July 1, 2005 with an expiration date of June 30, 2006 in the amount of $21.7 million, which represent the aggregate amount of Ondeo’s Claims for Indemnification against PRASA.

Following is the activity for the noncurrent portion of the allowance for losses on guarantees and letters of credit for the year ended June 30, 2005:

	Beginning Balance	Credit	Reimbursement	Ending Balance
GDB Operating Fund	$ 1,000,000	$ -	$ -	$ 1,000,000
Tourism Development Fund	7,049,150	(1,779,790)	-	5,269,360
Total	$ 8,049,150	$ (1,779,790)	$ -	$ 6,269,360

15. DERIVATIVE INSTRUMENTS

The Bank has entered into several interest rate exchange agreements (swaps) and an equity-linked exchange agreement to manage its exposure in certain debt instruments or derivative instruments as follows:

- Interest rate exchange agreements (swaps) to convert a portion of its floating rate certificate of indebtedness deposits to fixed rate.
- Interest rate exchange agreements to convert its variable rate bonds to fixed rate.
- An agreement to convert the payment on a deposit from Microsoft Puerto Rico, Inc. from a Microsoft Corporation share appreciation index to a fixed rate.

At June 30, 2005, the Bank was a party to the following interest-rate swap agreements (notional and amount and fair value in thousands):

		Receives					
Notional Amount	Floating Rate Indicator	Type	Rate at June 30, 2005	Pays Type	Pays Rate	Maturity Date	Fair Value June 30, 2005
$ 50,000	3m LIBOR – 0.75	Variable	2.78%	Fixed	4.715%	July 1, 2006	$ (797)
60,000	5m LIBOR – 0.75	Variable	2.78%	Fixed	4.710%	July 1, 2006	(958)
60,000	3m LIBOR – 0.75	Variable	2.78%	Fixed	4.710%	July 1, 2006	(971)
267,000	VRDOs(1)	Variable	2.14%	Fixed	3.040%	August 1, 2007	(2,493)
200,000	MSFT(2)	MSFT(2)	—	Fixed	4.999%	February 14, 2006	(7,337)
$ 637,000							$(12,556)

(1)Variable Rate Demand Obligations Rate—The variable rate received under this agreement corresponds to the rate set on a weekly open-market auction in which the underlying bonds are offered for sale.

(2)Microsoft Corporation share appreciation index, which mirrors an embedded derivative on a $200 million Microsoft certificate of indebtedness.

By using derivative financial instruments to hedge the exposure to changes in interest rates and equity-linked deposits, the Bank exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the term of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Bank, which creates credit risk for the Bank. When the fair value of a derivative contract is negative, the Bank owes the counterparty and, therefore, does not possess credit risk. The Bank minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties whose credit rating is acceptable under the Investment Policies of the Bank.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest-rate swap contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

The Bank assesses interest rate cash flows risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. The Bank maintains risk management control systems to monitor interest rate cash flow risk attributable to both the Bank's outstanding or forecasted debt obligations as well as the Bank's offsetting hedge positions. The risk management control systems involve the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on the Bank's future cash flows.

The Bank uses variable-rate debt to finance its operations. The debt obligations expose the Bank to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of a portion of its interest payments. To meet this objective, management enters into interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps change the variable rate cash flow exposure on the debt obligations to fixed cash flows. Under the terms of the interest rate swaps, the Bank receives variable interest rate payments and makes fixed interest rate payments, thereby creating the equivalent of fixed-rate debt.

16. RETIREMENT SYSTEM

Defined Benefit Pension Plan

The Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (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 under 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 of the Commonwealth. 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.

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 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 by the same statute to contribute 9.275% of each participant's gross salary.

Defined Contribution Plan

The Legislature of the Commonwealth 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 by Act No. 305 to contribute 9.275% 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.

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.

Total employee contributions for the defined benefit pension plan and the defined contribution plan during the year ended June 30, 2005 amounted to approximately $1,656,000. The Bank's contributions during the years ended June 30, 2005, 2004, and 2003 amounted to approximately $1,864,000, $1,733,000, and $1,810,000, 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.

Additional information on the Retirement System is provided in its stand-alone financial statements for the year ended June 30, 2005, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities, PO Box 42004, San Juan, PR 00940-2004.

17. COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Bank leases office space principally from another component unit of the Commonwealth under noncancelable operating leases, the latest of which expires in 2006. Rent charged to operations in 2005 amounted to approximately $1.2 million. At June 30, 2005, the minimum annual future rentals under noncancelable leases are approximately $851,000 for the fiscal year ending June 30, 2006.

Cooperative Development Investment Fund

On August 18, 2002, the Legislature of the Commonwealth approved Law 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, 2005, the Bank has contributed $7.2 million to the Cooperative Development Investment Fund, $2.2 million of which were contributed during the year ended June 30, 2005.

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.

Custodial Activities of Enterprise Funds

At June 30, 2005, the Housing Finance Authority was custodian of $106,794 in restricted funds of CRUV. As of June 30, 2005, such funds are deposited with the Bank. These funds are not owned by the Housing Finance Authority's enterprise funds and thus are not reflected in the basic financial statements.

At June 30, 2005, the Authority was the custodian of approximately $15,322 designated for the improvements to be made to the Puerto Rico Department of Housing building. The Authority's management has included these funds in the enterprise fund as an asset, included within cash and due from banks, and a liability to the Puerto Rico Department of Housing.

Loan Sales and Securitization Activities

On July 13, 1992, the Housing Bank and Agency entered into an agreement to securitize approximately $20.7 million of mortgage loans into a FNMA certificate. The Housing Finance Authority agreed to repurchase, at a price of par plus accrued interest, each and every mortgage loan backing up such security certificate that became delinquent for 120 days or more. As of June 30, 2005, the aggregate outstanding principal balance of the loans pooled into the FNMA certificate amounted to $1,027,877.

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, 2005, the principal balance of the mortgage loans serviced for others is as follows:

Popular Mortgage, Inc.	$31,628,191
R-G Mortgage, Inc.	8,968,336
CRUV or its successor without guranteed mortgage loan payments	73,345
Other investors, with guarnateed mortgage loan payments	512,335
Total	$41,182,207

Litigation

The Bank is a defendant in several lawsuits arising out of the normal course of business. Management, based on discussion with legal counsel, is of the opinion that the ultimate liability, if any, resulting from these pending proceedings will not have a material effect on the financial position or results of operations of the Bank.

On August 6, 2003, the Tourism Fund initiated foreclosure on the mortgage note it holds as collateral for the guarantee on the AFICA Cayo Largo bonds. The indenture of the bonds requires the repayment of the bonds before the execution of the mortgage note. Therefore, in order to execute the mortgage note, the Tourism Fund obtained a line of credit from the Bank just prior to filing the foreclosure action, with which the Tourism Fund called the outstanding balance of the bonds. Said bonds amounted to $75.6 million. Management believes that the specific allowance that has been established for this project, which is included as part of the allowance for loan losses, is adequate.

Resulting from the above-mentioned foreclosure proceedings, several of the principals of the Cayo Largo Hotel development (Cayo Largo Resort Associates, Cayo Largo Hotel, and D. Group Equity Holdings) have counterclaimed by filing complaints for alleged damages and breach of contract by the Tourism Fund aggregating to approximately $210 million. In addition, United States Fidelity and Guaranty Company (the "insurer") has filed an action to obtain a declaration that it is not bound to perform under the performance and payment bond executed in connection with the construction and development of the project. Management believes that the ultimate outcome of all the counterclaims and other actions, the last of which was filed on February 11, 2004, will not be material.

18. NO-COMMITMENT DEBT AND PROGRAMS SPONSORED BY THE HOUSING FINANCE AUTHORITY

The Public Finance Corporation has issued approximately $6 billion of Commonwealth appropriation bonds (the "Bonds") maturing at various dates through 2031. The proceeds of the Bonds, except for approximately $1.7 billion, have been 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 "Notes"). The $1.7 billion referred to above were used to refund a portion of certain bonds issued by the Public Finance Corporation (also no-commitment debt) between fiscal years 1995 and 2000. The outstanding balance of the Bonds at June 30, 2005 amounted to approximately $4.3 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 Notes. Principal and interest on the 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 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 Notes. The underlying 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 no-commitment 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 no-commitment debt as more fully described in Note 1. At June 30, 2005, 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	$ 85,192,092
Restricted liabilities (no commitment debt)	65,955,083
Restricted fund balance	$ 19,237,009
Excess of fund expenses over revenues	$ 895,724

In addition, the Housing Finance Authority issued in December 2003 $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 no-commitment debt and are not presented in the accompanying basic financial statements. The outstanding balance of these bonds amounted to $667 million at June 30, 2005.

Also, the Housing Finance Authority, as a public housing agency, is authorized to administer the U.S. Housing Act Section 8 Program in Puerto Rico. The revenues and expenses of such federal financial assistance are accounted for as a major governmental fund under HUD Programs.

Revenues and expenditures related to the administration of the U.S. Housing Act Section 8 Program amounted to $113,823,830 for the year ended June 30, 2005. This amount excludes $4,570,465 of administrative fees for services performed as contract administrator, which are reimbursed by the U.S. Department of Housing and Urban Development.

19. CONTRIBUTION TO THE SPECIAL COMMUNITIES IRREVOCABLE TRUST FUND

On November 21, 2002, the Legislature of the Commonwealth approved Joint Resolution No. 1027, authorizing the Bank to transfer $500 million as a contribution to the Special Communities Trust (the "Special Communities Trust"), an entity created for the purpose of financing a variety of initiatives, primarily housing and infrastructure, directed to the betterment of disadvantaged communities across the island. As approved in the Joint Resolution, the contribution will be disbursed following approved laws and regulations. The board of directors of the Bank approved a regulation (the "regulation"), which calls for the disbursement of contributions based on the compliance with certain reimbursement requirements.

In addition, the Legislature approved on November 21, 2002 Joint Resolution No. 1028, which authorized the Special Communities Trust to borrow up to $500 million in order to carry out the initiatives with which it was entrusted. This Joint Resolution authorizes the Bank to provide such financing, and requires the Director of the OMB to include in the budget of the Commonwealth submitted annually to the Legislature, for a period of ten fiscal years starting with the budget of fiscal year 2004-2005, the sum of $50 million plus accrued interest for the repayment of such borrowings. The appropriations shall be made from the product of the sale of public improvement bonds issued during each of said fiscal years. The Bank approved a line of credit with aggregate borrowings of $500 million. Disbursements under this line of credit will also be subject to the regulation.

On December 21, 2004, the Governor of the Commonwealth issued an executive order establishing the creation, through the Bank, of an irrevocable trust to guarantee compliance with the abovementioned Joint Resolutions. As established by the order, the Bank will fund into the trust the previously unfunded amounts authorized under the Joint Resolutions. The beneficiary of the trust will be the Special Communities Trust. Consequently, both the contribution and the loan were fully disbursed in December 2004. As of June 30, 2005 the loan balance was approximately $425.1 million.

20. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

For a significant portion of the Bank's financial instruments (principally loans and deposits) fair values are not readily available since there are no available trading markets. Accordingly, fair values can only be derived or estimated using valuation techniques, such as present-valuing estimated future cash flows using discount rates, which reflect the risk involved, and other related factors. Minor changes in assumptions or estimation methodologies may have a material effect on the results derived therefrom.

The fair values reflected below are indicative of the interest rate environment as of June 30, 2005, and do not take into consideration the effects of interest rate fluctuations. In different interest rate scenarios, fair value results can differ significantly. Furthermore, actual prepayments may vary significantly from those estimated resulting in materially different fair values.

The difference between the carrying value and the estimated fair value may not be realized, since, in many of the cases, the Bank intends to hold the financial instruments until maturity, or because the financial instruments are restricted. Comparability of fair values among financial institutions is not likely, due to the wide range of permitted valuation techniques and numerous estimates that must be made in the absence of secondary market prices.

The following methods and assumptions were used by the Bank in estimating fair values of the financial instruments for which it is practicable to estimate such values:

- Short-term financial instruments, such as federal funds sold, cash and due from banks, repurchase and resale agreements, certificates of deposit, commercial paper, and accrued interest receivable and payable have been valued at the carrying amounts reflected in the statement of net assets, as these are reasonable estimates of fair value given the relatively short period of time between origination of the instruments and their expected realization.
- Financial instruments that are primarily traded in secondary markets, such as most investments, were valued using either market price, pricing models, or quoted market prices of financial instruments with similar characteristics.
- Financial instruments that are not generally traded, such as certificates of deposit and investment contracts, and bonds issued with fixed interest rates, were fair valued, for the most part, using the present values of estimated future cash flows at the appropriate discount rates. Bonds issued with interest rates floating within certain ranges were fair valued at their outstanding principal balance. The fair value of liabilities with no defined maturities, such as demand deposits, was reported as the amounts payable upon demand.
- Loans to the public sector were valued according to the type of contractual interest rate. Loans to the public sector with interest rates floating within certain ranges were fair valued at their outstanding principal balance. Loans to the public sector with fixed interest rates were fair valued assuming that such loans were packaged and sold in the secondary market. The discount rates utilized were based on the rating of the Commonwealth and the market where the instruments would be sold and were adjusted for various other factors, including issuance costs. For delinquent public sector loans, the fair value was assumed to be equal to the carrying value, as historically the Bank has collected such amounts.
- Loans and commitments to extend credit to the private sector are mostly industrial development, tourism development, and low-cost housing development projects. For these types of loans and commitments, there is no secondary market, and the actual future cash flows may vary significantly as compared to the cash flows projected under the agreements, due to the degree of risk. Accordingly, management has opted not to disclose the fair value to these financial instruments, as such information may not be estimated with reasonable precision.
- Disclosure of the fair value of commitments to extend credit, standby letters of credit, and guarantees relating to instrumentalities of the Commonwealth is omitted, as these arrangements are with component units of the Commonwealth.
- Interest rate swaps used in asset-liability management were valued using estimated market prices, based on discounted future cash flows.

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at June 30, 2005:

	Reported or Notional Amount	Fair Value
	(In millions)	
Financial assets:		
Cash and due from banks	$ 71	$ 71
Federal funds sold and securities purchased under agreements to resell	1,651	1,651
Deposits placed with banks	355	355
Investments and investment contracts	2,316	2,395
Loans to public sector	5,241	5,251
Accrued interest receivable and other receivable	148	148
Due from Puerto Rico Department of Housing and federal government	33	33
Financial liabilities:		
Demand deposits	1,675	1,675
Certificates of deposit	3,198	3,198
Certificates of indebtedness	261	261
Securities sold under agreements to repurchase	439	439
Commercial paper	1,191	1,191
Accounts payable and accrued liabilities	120	120
Accrued interest payable	24	24
Bonds and notes payable	1,490	1,410
Derivative instruments:		
Interest rate exchange agreements	637	(13)
Equity index option embedded in certificate of indebtedness	200	(3)

21. INTERFUND BALANCES AND TRANSFERS

The following table is a summary of the interfund balances as of June 30, 2005 between governmental funds and enterprise funds:

Receivable by	Payable by	Purpose	Amount
Governmental funds:	Enterprise funds:		
Affordable Housing Mortgage Subsidy Program - Stage 8	GDB Operating Fund	Demand deposits and accrued interest	$ 71,344
Affordable Housing Mortgage Subsidy Program - Stage 8	GDB Operating Fund	Certificates of deposit and accrued interest	28,035,875
Subsidy Prepayment Refunding Bonds - Debt Service	GDB Operating Fund	Demand deposits and accrued interest	462,223
New Secure Housing Program	Housing Finance Authority	Reimbursements of loan originations	514,662
New Secure Housing Program	GDB Operating Fund	Demand deposits and accrued interest	51,045
The Key for Your Home Program	GDB Operating Fund	Demand deposits, certificates of deposit and accrued interest	9,956,020
Other Non-Major Fund (AHMSP Portfolio IV)	Housing Finance Authority	Reimbursements of bond issue cost	2,527,427
Other nonmajor fund (Law 72)	GDB Operating Fund	Demand deposits and accrued interest	51,904
Other nonmajor fund (AHMSP Law 124)	GDB Operating Fund	Demand deposits and accrued interest	162
Other Non-Major Fund (Special Obligation Refunding Bonds-Debt Service)	GDB Operating Fund	Demand deposits and accrued interest	110,693
Other Non-Major Fund - Stage 7	GDB Operating Fund	Demand deposits and accrued interest	91
Balance carried forward			$ 41,781,446

Receivable by	Payable by	Purpose	Amount
Balance brought forward			$ 41,781,446
Enterprise funds:	Governmental funds:		
Housing Finance Authority	Subsidy Prepayment Refunding Bonds - Debt Service	Reimbursement of expenditures	(76,686)
GDB Operating Fund	New Secure Housing Program	Loan payable and accrued interest	(21,509,336)
GDB Operating Fund	Affordable Housing Mortgage Subsidy Program - Stage 9	Loan payable and accrued interest	(66,248,964)
Housing Finance Authority	The Key for Your Home Program	Reimbursement of expenditures	(477,839)
Housing Finance Authority	Other nonmajor fund (Law 72)	Reimbursement of expenditures	(102,037)
Housing Finance Authority	Other nonmajor fund (AHMSP stage 7)	Reimbursement of expenditures	(850,116)
Housing Finance Authority	Other nonmajor fund (AHMSP Law 124)	Reimbursement of expenditures	(302,307)
GDB Operating Fund	Other nonmajor fund Stage 7	Securities purchased under agreements to resell and accrued interest	(52,475,255)
GDB Operating Fund	Other nonmajor fund (AHMSP Law 124)	Reimbursement of expenditures	(99,541)
Housing Finance Authority	Other Nonmajor Fund (Special Obligation Refunding Bonds-Debt Service)	Reimbursement of expenditures	(73,869)
Total internal balances–net			$ (100,434,504)

Receivable by Fund	Payable by Fund	Purpose	Amount
Entreprise funds:	Entreprise funds:		
Housing Finance Authority	GDB Operating fund	Demand deposit and accrued interest	$ 13,183,286
Development Fund	GDB Operating fund	Demand deposit and accrued interest	16,591,526
Tourism Development Fund	GDB Operating fund	Demand deposit and accrued interest	5,881,378
Public Finance Corporation	GDB Operating fund	Demand deposit and accrued interest	1,032,423
Education Assistance Corp.	GDB Operating fund	Demand deposit and accrued interest	2,111,519
José M. Berrocal Institute	GDB Operating fund	Demand deposit and accrued interest	295,186
Housing Finance Authority	GDB Operating fund	Certificates of deposit and accrued interest	345,305,607
Tourism Development Fund	GDB Operating fund	Certificates of deposit and accrued interest	33,501,252
Housing Finance Authority	GDB Operating fund	Guaranteed investment contract	227,858,953
GDB Operating fund	Housing Finance Authority	Bonds payable	101,904,416
GDB Operating fund	Housing Finance Authority	Loans receivable and accrued interest	4,132,965
GDB Operating fund	Tourism Development Fund	Loans receivable and accrued interest	236,277,709
Total balance among enterprise funds eliminated			$ 988,076,220

The following table is a summary of interfund transfers for the year ended June 30, 2005:

Transfer out	Transfer in	Transfer for	Amount
Govermental funds:	Govermental funds:		
Affordable Housing Mortgage Subsidy Program - Stage 8	Key for Your Home Program	Subsidy payments	$ 60,730,032
Other nonmajor - Stage 2	Key for Your Home Program	Subsidy payments	9,530,000
Other nonmajor - Stage 7	Key for Your Home Program	Subsidy payments	11,551,438
Other nonmajor (AHMSP Law 124)	Other nonmajor - Stage 7	Debt service payments	1,500,000
Enterprise funds:	Govermental funds:		
Housing Finance Authority	Other nonmajor (Portfolio IV)	Debt service payments	99,819
Housing Finance Authority	Other nonmajor (Portfolio III)	Debt service payments	3,388,115
Govermental funds:	Enterprise funds:		
Affordable Housing Mortgage Subsidy Program - Stage 9	Housing Finance Authority	Refund debt service	12,193,033
Other nonmajor (Portfolio I)	Housing Finance Authority	Refund debt service	448,526
Other nonmajor (AHMSP Law 124)	Housing Finance Authority	Refund debt service	11,710
Other nonmajor (Portfolio III)	Housing Finance Authority	Refund debt service	5,613,202
Other nonmajor (Portfolio IV)	Housing Finance Authority	Refund debt service	822,974
Other nonmajor (Stage 7)	Housing Finance Authority	Loan insurance payments	412,509
Enterprise funds:	Enterprise funds:		
Other nonmajor (HO-Fifth Bonds)	Housing Finance Authority	Debt service payments	2,572,954

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APPENDIX II

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[PROPOSED FORM OF OPINION OF BOND COUNSEL]

May __, 2006

Government Development Bank for Puerto Rico
San Juan, Puerto Rico

Gentlemen:

We have examined Act No. 17 of the Legislature of Puerto Rico, approved September 23, 1948, as amended, creating Government Development Bank for Puerto Rico (hereinafter called "Development Bank") as a corporation and a governmental instrumentality of the Commonwealth of Puerto Rico (hereinafter called the "Commonwealth"). We have also examined certified copies of the proceedings of the Board of Directors of Development Bank authorizing the execution and delivery of a Trust Indenture, dated as of February 17, 2006, as supplemented (the "Trust Indenture"), by and between Development Bank and Banco Popular de Puerto Rico, trustee (the "Trustee"), and other proofs submitted relative to the authorization, issuance and sale of the following described notes (the "2006 Series B Notes")

$740,000,000
GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO
Senior Notes, 2006 Series B
Dated the date hereof.

Maturing in such principal amounts and subject to redemption, all as set forth in the Trust Indenture, and bearing interest at the rates set forth in the resolution of Development Bank awarding the 2006 Series B Notes. The proceeds of the 2006 Series B Notes will be applied by Development Bank either to retire obligations incurred by Development Bank to finance lines of credit granted by Development Bank to certain agencies, instrumentalities and public corporations of the Commonwealth (the "Benefited Entities"), to reimburse Development Bank for advances of its internal resources to finance lines of credit granted by Development Bank to the Benefited Entities and to provide funds for future draws on said lines of credit.

Pursuant to the Trust Indenture, Development Bank is authorized to issue additional securities from time to time upon the terms and conditions set forth therein, and any such securities will be on a parity with the 2006 Series B Notes and all other securities issued under the Trust Indenture (all such additional securities together with the 2006 Series B Notes being herein collectively called the "Notes").

The principal of and the interest on the 2006 Series B Notes and all other securities issued by Development Bank under the Trust Indenture are payable from any available funds of Development Bank, all as provided in the Trust Indenture.

We have also examined one of the 2006 Series B Notes as executed and authenticated.

From such examination we are of the opinion that:

1. Said Act No. 17, as amended, is valid.

2. Said proceedings have been validly and legally taken.

3. The 2006 Series B Notes have been duly authorized and issued and are valid and binding obligations of Development Bank, payable from any available funds of Development Bank, which funds have been pledged to the payment of the principal of and interest on all Notes issued under the Trust Indenture.

4. Under the provisions of the Acts of Congress now in force and under existing regulations, rulings and court decisions, (i) subject to compliance with the covenant referred to below and requirements of the Internal Revenue Code of 1986, as amended (the "Code"), regarding use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the Treasury of the United States, if required, interest on the 2006 Series B Notes is not includable in gross income for federal income tax purposes, and (ii) the 2006 Series B Notes and the interest thereon are exempt from state, Commonwealth and local income taxation.

Interest on the 2006 Series B Notes is not an item of tax preference for the purpose of the federal alternative minimum tax imposed on individuals and corporations by the Code. Such interest will, however, be includable in the computation of the alternative minimum tax on corporations imposed by the Code. The Code contains other provisions that could result in tax consequences, upon which we express no opinion, as a result of (a) ownership of the 2006 Series B Notes or (b) the inclusion in certain computations (including, without limitation, those related to the corporate alternative minimum tax) of interest that is not included in gross income. No opinion is rendered by the undersigned on the effect of any action taken or not taken after the date of this opinion without the approval of the undersigned (except for such action or omission to act as otherwise provided for in the documents pertaining to the 2006 Series B Notes) or in reliance upon the advice of counsel other than the undersigned on the exclusion from gross income of the interest on the 2006 Series B Notes for federal income tax purposes.

Each of Development Bank and the Benefited Entities has covenanted to comply to the extent permitted by the Constitution and laws of the Commonwealth, with the requirements of the Code, so that interest on the 2006 Series B Notes will remain exempt from federal income taxes to which it is not subject on the date of issuance of the 2006 Series B Notes. We are not aware of any provision of the Constitution or laws of the Commonwealth which would prevent Development Bank or the Benefited Entities from complying with the requirements of the Code.

Respectfully submitted,

[To Be Signed, "Sidley Austin LLP]

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