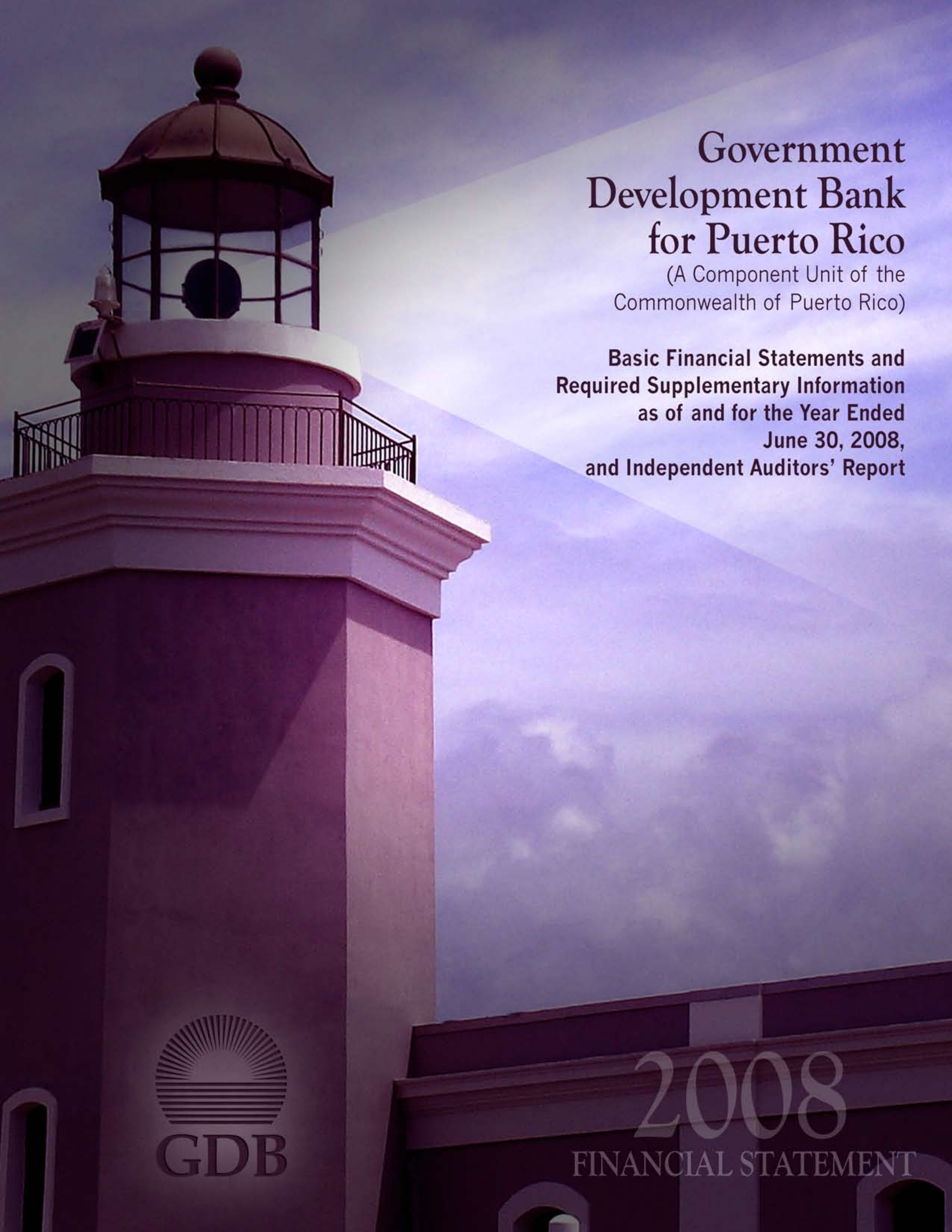
Government Development Bank for Puerto Rico

(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, 2008, and Independent Auditors' Report



GDB

2008

FINANCIAL STATEMENT

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

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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, 2008, 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, 2008, and the respective changes in financial position and, where applicable, respective cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 2 and 5 to the financial statements, loans to the Commonwealth of Puerto Rico, its agencies and instrumentalities amounted to approximately $3,997,471,000 or 32% of the Bank's total assets as of June 30, 2008. These loans are expected to be collected from appropriations from, bond issuances of, or revenues generated by the Commonwealth of Puerto Rico, its agencies and instrumentalities. The Commonwealth's recurring expenditures have exceeded its recurring revenues during the past six years and its credit ratings have been lowered. The collectibility of these loans may be affected by budgetary constraints, the fiscal situation and the credit rating of the Commonwealth of Puerto Rico, its agencies and instrumentalities, and their ability to generate sufficient funds from taxes, charges and/or bond issuances. Significant negative changes in these factors may have an adverse impact on the Bank's financial condition, liquidity, funding sources, and results of operations.

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 Government Development Bank for Puerto Rico'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

December 19, 2008

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2008

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, 2008. 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, 2008 amounted to $12,316 million and $9,957 million, respectively, for net assets of $2,359 million or 19.2% of total assets.
- Net assets increased during the fiscal year by $87.5 million. The increase in net assets comprises $98.1 million from business-type activities, and a loss of $10.6 million from governmental activities.
- An early retirement program was approved and implemented at a cost of $40.2 million. Change in net assets excluding this item was $127.7 million.

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, 2008 amounted to $12,316 million and $9,957 million, respectively, for net assets of $2,359 million or 19.2% of total assets. Total assets had a moderate growth of $389 million or 3.26% over fiscal year 2007, but the composition of assets changed significantly. At June 30, 2008, total invested assets other than loans ($6,338 million) to total assets increased to 51.5% from 42% at June 30, 2007, while loans to total assets decreased to 44.4% from 52.3% as of June 30, 2007. The change in composition resulted from the repayment of various government sector loans as part of the Sales Tax Financing Corporation bond issuances Series 2007 A & B. (Refer to Note 5.)

From the $2,359 million in net assets, $1,986.4 million or 84.2% are unrestricted, $260 million or 11.0% are restricted for use in affordable housing programs, and the remaining $112.3 million or 4.8% 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 $200 million at June 30, 2008, before $92 million in net balances due to business-type activities. Total liabilities amounted to $25.3 million, for net assets of $83.1 million or 76.7% 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 $30.5 million and for affordable housing programs of $84.9 million, and the unrestricted deficit of $32.3 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, 2008 and 2007 is shown below (amounts in thousands):

	June 30			
	2008	2007	Amount	Percent
Assets:				
Other assets	$ 346	$ 363	$ (17)	(4.7)%
Restricted:				
Cash and due from banks, and deposits placed with banks	54,896	47,556	7,340	15.4%
Due from federal government	20,937	18,823	2,114	11.2%
Investments and investment contracts	118,011	86,787	31,224	36.0%
Loans receivable — net	2,520	2,899	(379)	(13.1)%
Other assets	3,699	2,005	1,694	84.5%
Total assets before internal balances	200,409	158,433	41,976	26.5%
Internal balances	(92,028)	(31,606)	(60,422)	191.2%
Total assets	108,381	126,827	(18,446)	(14.5)%
Liabilities:				
Accounts payable and accrued liabilities	20,322	22,933	(2,611)	(11.4)%
Notes payable:				
Due in one year	151	39	112	287.2%
Due in more than one year	4,811	10,160	(5,349)	(52.6)%
Total liabilities	25,284	33,132	(7,848)	(23.7)%
Net assets:				
Restricted for debt service	30,523	25,504	5,019	19.7%
Restricted for affordable housing programs	84,905	78,596	6,309	8.0%
Unrestricted deficit	(32,331)	(10,405)	(21,926)	210.7%
Total net assets	$ 83,097	$ 93,695	$ (10,598)	(11.3)%

Investments and investment contracts amounted to $118 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 $54.9 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 (the "Housing Finance Authority") and for debt service. Governmental activities also have a balance due from the federal government of $20.9 million that is related to the reimbursement of eligible expenses incurred for the New Secure Housing Program.

The most significant liabilities of governmental activities are the notes payable amounting to $5.0 million at June 30, 2008, down by $5.2 million or 51.3%, from $10.2 million at June 30, 2007.

Condensed financial information on expenses, program and general revenues, and changes in net assets of governmental activities for the years ended June 30, 2008 and 2007, is shown below (in thousands):

	Year ended June 30, 2008		
	General Government	Housing Assistance Programs	Total
Expenses	$ 5,165	$144,438	$149,603
Program revenues:			
Charges for services — financing and investment		10,228	10,228
Operating grants and contributions	-	133,012	133,012
Net expenses	$ (5,165)	$ (1,198)	(6,363)
General revenues — unrestricted income			
Transfers — net			(4,235)
Change in net assets			(10,598)
Net assets — beginning of year			93,695
Net assets — end of year			$ 83,097

	Year ended June 30, 2007		
	General Government	Housing Assistance Programs	Total
Expenses	$ 4,514	$ 165,056	$ 169,570
Program revenues:			
Charges for services — financing and investment		10,829	10,829
Operating grants and contributions	-	199,284	199,284
Net (expenses) revenues	$ (4,514)	$ 45,057	40,543
Transfers — net			27,444
Change in net assets			67,987
Net assets — beginning of year			25,708
Net assets — end of year			$ 93,695

4. GOVERNMENTAL FUND RESULTS

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

New Secure Housing Program ("Nuevo Hogar Seguro") — 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 or that live in hazard prone areas. This fund receives resources from the federal government, under a Federal Emergency Management Agency program, intended to provide financial resources to eligible participants for the relocation or reconstruction of their homes. The Housing Finance Authority restructured on a long term basis its existing $50 million revolving credit facility with GBD to complete the new secure housing program by December 2009. The obligation will require debt service payments of approximately $67.6 million over a period of 20 years.

No revenues from the federal government or from appropriations of the Commonwealth of Puerto Rico (the "Commonwealth") were recognized during 2008 compared to $4.6 million and $0.2 million recognized in 2007, respectively. Construction costs paid during the years ended June 30, 2008 and 2007, amounted to approximately $6.1 million and $13.2 million, respectively, which are presented as housing assistance program expenditures in the accompanying statement of revenues, expenditures, and changes in fund balances — governmental funds. The decrease in eligible expenditures is in direct relation to the reduced number of projects being developed and financed through this fund.

The Key for Your Home Program — This fund accounts for the subsidy to low and moderate-income families of costs directly related to the purchase and rehabilitation of housing units. Housing Finance Authority financed the continuation of this program with the transfer of $38.8 million from the Affordable

Housing Mortgage Subsidy Program (AHMSP) - Law 124 governmental fund. This amount represents a portion of the amounts released from the advance refunding transaction executed last fiscal year. Act No. 124, the enabling legislation pursuant to which the AHMSP was created, allows for the transfer of fund surplus, among other permissible uses, to increase the Key for Your Home Program fund.

Total revenues during fiscal year 2008 and 2007 were $3.7 million and $2.9 million, respectively. Revenues arose principally from penalty reimbursements received from early payment of mortgages and interest income on deposits placed with banks. The fund had expenditures of $12.8 million and $18.1 million in 2008 and 2007, respectively.

HUD Programs — This fund accounts for the U.S Housing Act Section 8 programs administered by the Housing Finance Authority under the authorization of the U.S. Department of Housing and Urban Development (HUD). Presently, the Housing Finance Authority operates four programs whereby low-income families receive directly or indirectly subsidies to pay for their rent. The housing vouchers program enables families to obtain rental housing in a neighborhood of their choice. The other programs are project-based subsidies whereby housing developers are given incentives to keep their properties available for certain markets. The expenditures of the HUD programs decreased $4.2 million from $119.8 million in 2007 to $115.6 million in 2008. The expenditures in the housing vouchers program increased $1.3 million because 197 additional vouchers were awarded when compared to the previous year. In the moderate rehabilitation program, two projects were transferred directly to HUD causing a decrease of $0.3 million versus fiscal year 2007. The decrease in the new construction program of $25 million was mostly related to the net increase of $20 million in the PBCA program because 19 new construction projects were incorporated to the PBCA program. In addition, 14 existing PBCA program projects were transferred under the direct supervision of HUD accounting for the additional decrease in the PBCA program compared to the prior year.

AHMSP Stages 7, 8 and 9 — The Stage 7 is a major fund and Stages 8 and 9 are nonmajor funds but management has elected to present these separately in the balance sheet and statement of revenues, expenditures and changes in fund balance to be consistent with their presentation in prior years. Following is an analysis of the operations of these funds:

These funds' operating objective is to provide funds for low income families to be used either for the down payment on mortgages or mortgage subsidy payments. The funds receive appropriations from the Commonwealth to fund these payments.

AHMSP Stage 7 — Expenditures exceeded revenues by $3.5 million for the year ended June 30, 2008. This is attributed to appropriations from the Commonwealth expected to be received for the payment of the annual debt service.

AHMSP Stage 8 — This fund had a decrease in fund balance of $95.7 thousand resulting from revenues of $0.84 million reduced for total expenditures of $0.86 million and transfers out of $79.5 thousand.

AHMSP Stage 9 — During the year ended June 30, 2008, the fund received an appropriation from the Commonwealth in the amount of $5.4 million. These funds were used to repay advances from the Bank that were used to fund subsidy escrows.

Business-Type Activities

Condensed financial information on assets, liabilities, and net assets as of June 30, 2008 and 2007, is presented below (amounts in thousands):

	June 30, 2008	June 30, 2007	Change Amount	Change Percent
Assets:				
Cash and due from banks	$ 81,922	$ 29,688	$ 52,234	175.9%
Federal funds sold	316,620	945,500	(628,880)	(66.5)%
Deposits placed with banks	1,566,118	1,881,810	(315,692)	(16.8)%
Investments and investment contracts	4,287,850	2,048,405	2,239,445	109.3%
Loans receivable — net	5,460,899	6,238,862	(777,963)	(12.5)%
Interest and other receivables	262,630	472,506	(209,876)	(44.4)%
Capital assets	27,397	24,525	2,872	11.7%
Other assets	112,150	127,355	(15,205)	(11.9)%
Internal balances	92,028	31,606	60,422	191.2%
Total assets	12,207,614	11,800,257	407,357	3.5%
Liabilities:				
Deposits:				
Demand	2,720,148	2,013,883	706,265	35.1%
Certificates of deposit	4,283,385	3,444,110	839,275	24.4%
Certificates of indebtedness	11,800	11,800	-	0.0%
Securities sold under agreements to repurchase	687,200	455,000	232,200	51.0%
Commercial paper	500	575,861	(575,361)	(99.9)%
Accrued interest payable	27,909	47,742	(19,833)	(41.5)%
Accounts payable, accrued liabilities, and other liabilities	94,959	113,009	(18,050)	(16.0)%
Bonds and notes payable:				
Due in one year	156,652	187,678	(31,026)	(16.5)%
Due in more than one year	1,949,435	2,773,629	(824,194)	(29.7)%
Total liabilities	9,931,988	9,622,712	309,276	3.2%
Net assets:				
Invested in capital assets	27,397	24,525	2,872	11.7%
Restricted for:				
Affordable housing programs	175,073	146,691	28,382	19.3%
Mortgage loan insurance	54,386	49,135	5,251	10.7%
Unrestricted	2,018,770	1,957,194	61,576	3.1%
Total net assets	$ 2,275,626	$ 2,177,545	$ 98,081	4.5%

Federal Funds Sold and Deposits Placed with Banks — The Bank reduced its federal funds sold by $628.9 million or 66.5%, from $945.5 million at June 30, 2007 to $316.6 million at June 30, 2008, and its deposits placed with banks by 16.8%, from $1,882 million to $1,566 million. The Bank increased its investments to obtain a better yield.

Investments and Investment Contracts — Investments and investment contracts held in business-type activities amounted to $4,288 million at June 30, 2008. This amount also represents an increase of $2,239 million or 109% when compared to the prior year balance of $2,048 million.

The investment portfolio comprised 35.1% of the total assets of the Bank's business-type activities at June 30, 2008, compared to 17.4% at the close of fiscal year 2007. Within the investment securities portfolio, $1,653 million at June 30, 2008 and $1,253 million at June 30, 2007 were restricted or pledged as collateral or payment source for specific borrowings.

Loans Receivable — Net loans receivable of $5,461 million accounted for 44.7% of total assets of business-type activities at June 30, 2008 (52.9% in 2007). The decrease of $778 million in net loans was driven by a decrease in public sector loans of approximately $835 million.

Act No. 91 of the Legislature of the Commonwealth of Puerto Rico, as amended, created the Puerto Rico Sales Tax Financing Corporation (the "Sales Tax Corporation") for the purpose of financing the payment, retirement or defeasance of certain outstanding obligations of the Commonwealth at June 30, 2006, payable to the Bank and the Public Finance Corporation. Debt payable from legislative appropriations is designated as extra-constitutional debt. As of June 30, 2008 and 2007, the Bank had $1.1 billion and $2.8 billion, respectively, of extra-constitutional debt in its public loans portfolio. This decrease was due to the issuance on July 31, 2007, by the Sales Tax Corporation of the 2007 Series A and B bonds from whose proceeds the Bank collected $1.7 billion or 61% of said loans. (Refer to Note 5 of the basic financial statements.)

The creation of the "Municipal Redemption Fund" that is nourished from part of the Municipal Sales Tax triggered a growth in loans to the municipalities by increasing their debt margin capacity. As of June 30, 2008, loans to the public sector include $991 million of loans to the municipalities, an increase of $401 million, or 68%, over prior fiscal year balance of $590.5 million. At June 30, 2008, $270 million of municipal loans are payable from the Municipal Redemption Fund.

Private sector loans outstanding at June 30, 2008 and 2007 amounted to $474 million and $418 million, respectively, net of an allowance for loan losses of $31 million at the end of both years. Private sector loans mainly include loan facilities for the housing and tourism sectors through some component units of the Bank.

Capital Assets — Capital assets, net of accumulated depreciation and amortization, amounted to $27.4 million at June 30, 2008, an increase of $2.9 million from prior year. The increase was mainly due to the relocation costs of a component unit and the implementation of new software. See Note 7 to the basic financial statements for additional information on capital assets.

Other Assets — Other assets amounted to $112.2 million at June 30, 2008, a decrease of $15.2 million from prior year, resulting from the sale of a land with a book value of $13 million at a $4.3 million gain.

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 increase of $1,546 million, from $5,458 million at June 30, 2007 to $7,004 at June 30, 2008.

Securities Sold Under Agreement to Repurchase — Securities sold under agreements to repurchase increased by $232 million or by 51% from $455 million to $687 million at June 30, 2008. These obligations partially replaced commercial paper as a source of funding.

Commercial Paper — Increased cost and the cancellation of loans funded with commercial paper reduced its balance to a minimum of $500,000, a decrease of 99.9%, from $575.9 million at June 30, 2007.

Other Borrowed Funds — Bonds and notes payable decreased by 28.9% from $2,961 million at June 30, 2007 to $2,106 million at June 30, 2008. This decrease is the result of the annual debt service of $188 million, and the cancellation of the $885 million Senior Notes, Series 2006A. The notes were called after various swap agreements matched to the notes were called by the counterparties because of market conditions. (Refer to Note 12).

Condensed financial information on expenses, program revenues, and changes in net assets for business-type activities for the years ended June 30, 2008 and 2007 is presented below (in thousands):

	Year ended June 30, 2008			
		Program revenues		
		Charges for services		
Activity	Expenses	Fees, commissions, and other	Financing and investment	Net revenues (expenses)
GDB Operating Fund	$381,694	$35,759	$453,163	$ 107,228
Housing Finance Authority	92,053	10,905	97,610	16,462
Tourism Development Fund	16,159	3,408	21,377	8,626
Public Finance Corporation	7,165		7,234	69
Capital Fund	68	59	(4,835)	(4,844)
Development Fund	(5,099)	58	1,498	6,655
Other nonmajor	182	-	75	(107)
Total	$492,222	$50,189	$576,122	134,089
Special items — Early Retirement Program				(40,243)
Transfers to governmental activities				4,235
Change in net assets				98,081
Net assets — beginning of year				2,177,545
Net assets — end of year				$2,275,626

	Year ended June 30, 2007			
		Program revenues		
		Charges for services		
Activity	Expenses	Fees, commissions, and other	Financing and investment	Net revenues (expenses)
GDB Operating Fund	$500,702	$15,137	$565,727	$ 80,162
Housing Finance Authority	85,318	12,203	106,599	33,484
Tourism Development Fund	11,955	3,278	24,533	15,856
Public Finance Corporation	20,404	10	20,256	(138)
Capital Fund	73	13	13,147	13,087
Development Fund	10,095	34	1,927	(8,134)
Other nonmajor	168	-	111	(57)
Total	$628,715	$30,675	$732,300	134,260
Transfers to governmental activities				(27,444)
Change in net assets				106,816
Net assets — beginning of year				2,070,729
Net assets — end of year				$2,177,545

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 $453.2 million from its loan and investment portfolios, and $35.8 million in other charges for services. These revenues covered $381.7 million in expenses for net revenues from GDB Operating Fund of $107.2 million, surpassing the net revenues of any other activity.

The Housing Finance Authority activities were the second largest contributor to the change in net assets with net revenues of $16.5 million. Other contributors to the change in net assets were the Tourism Development Fund and the Development Fund with net revenues of $8.6 million and $6.7 million, respectively.

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 $10,896 million at June 30, 2008, compared to $10,699 million at June 30, 2007. This represents an increase of $197 million, which was mainly driven by net decreases in loans to the public sector of approximately $835 million and in accrued interest receivable of $210 million while invested assets increased by $1,176 million. As previously discussed, the Bank received from the Sales Tax Corporation a payment of $1.7 billion for loans to the public sector that constitutes extra-constitutional debt. (Refer to note 5.)

With the proceeds from the collection of loans, the Bank cancelled most of its related funding, such as commercial paper ($575 million net decrease). However, deposits grew considerably by $1,532 million, or 25%, from $6,148 million at June 30, 2007 to $7,680 million related to the deposit of amounts to cover the Commonwealth's debt service requirements.

Change in net assets of the GDB Operating Fund decreased 5.4% from $80.2 million in 2007 to $75.8 million in 2008. Following is a discussion of 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 investment income, the difference between investment income and interest expense, decreased by $15 million or 11.8%, from $127.6 million in 2007 to $112.5 million in 2008. During fiscal year 2008, lower interest rates prevailed affecting almost proportionately both interest income and expense. However, the fair value of investments decreased by $11.6 million or 73.4%, from $15.8 million in 2007 to $4.2 in 2008.

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

In 2007, after years of litigation, the Bank recognized an allowance of $11.8 million for a loan to a municipality due to uncertainties regarding its collection (Refer to note 5 to the basic financial statements). For fiscal year 2008, management believes that there is no need for further provisions for either the loan portfolio or the guarantees and letters of credit. At June 30, 2008 management expects that the negotiation with the municipality will result in a favorable outcome to the Bank.

(c) Noninterest Income

Fiscal agency fees constitutes the main component of non-interest income. The intense activity during the year in both volume and number of bond issuances where the Bank acted as fiscal agent increased this income item from $8.8 million to $20.2 million or by $11.4 million. Also, the sale of a land produced a gain of $4.3 million contributed to the favorable variance of $20.6 million in 2008 as compared to the non-interest income for 2007 of $15.1 million.

(d) Noninterest Expenses

Noninterest expense decreased $9 million during fiscal year 2008, but basically because 2007 figures were higher as a result of the disposition of certain capital assets and a provision for other assets.

(e) Special Item

During fiscal year 2008, the Bank's board of directors authorized and granted an early retirement program at a cost of $31.4 million. Excluding this item, the change in net assets of the Bank was $107.2 million, $27 million over previous year results of $80.2 million.

Housing Finance Authority — Net assets of the Housing Finance Authority increased $12 million from $534 million as of June 30, 2007 to $546 million as of June 30, 2008. The Housing Finance Authority had total revenues of $109 million for the year ended June 30, 2008 a decrease of $10 million from 2007. This decrease is mainly due to less favorable market conditions, which resulted in a loss in the fair value of the investments of $.8 million in 2008 from a gain of $2 million in 2007, and to a decrease of $6 million in investment and interest income resulting from lower average balances in investments. In addition, non-interest income decreased by $1 million due to a reduction in commitment and other fees, mainly related to the fees earned on the administration of the HUD Programs, and to a lower gain on sale of housing program loans. Total operating expenses of the Housing Finance Authority increased from $85 million in 2007 to $92 million in 2008. The main factor of the increase of $7 million was the collection of an advance to the Puerto Rico Department of Housing in 2007 which resulted in the reversal of a $15 million allowance for losses that had been established for this advance in 2006. Also, interest expense decreased by $3 million due to a lower average balance of borrowings as a result of annual repayments.

Capital Fund — The Capital Fund's total net assets decreased $4.8 million, which represents a negative variance of $17.9 million when compared to the prior year increase of $13.1 million. The results of the Capital Fund are determined by the fluctuations of the investment market and the resulting change in fair value of investments that in 2008 decreased by approximately $17.9 million.

Development Fund — The Development Fund net revenues were mostly the result of a $6.4 million credit to the reserve for legal claims due to settlement of an outstanding case.

Tourism Development Fund — Total assets increased to $393.6 million from $356.6 million in 2007. The growth in assets is related to the increase in loans. The Tourism Development Fund mostly finance its loan portfolio through facilities obtained from the Bank. Notes payable due to the Bank at year-end were $213 million for an increase of $35 million from June 30, 2007. At June 30, 2008, outstanding guarantees and letters of credit of the Tourism Development Fund amounted to $128.8 million. Net assets of the Tourism Development Fund increased $8.6 million during the year to $149.9 million at June 30, 2008.

Public Finance Corporation — Change in net assets increased to $69,000 from a loss of approximately $137,600 in 2007. The most significant activity of the Corporation was in the reduction of its no-commitment debt, from $4.3 billion as of June 30 2007 to $1.72 billion as of June 30, 2008, due to the payments received from the proceeds of the Sales Tax Corporation bond issuances of 2007, discussed above. (Refer to Note 17.)

5. DEBT

Total bonds and notes outstanding at year-end amounted to \$2,106 million of which \$1,150 million are payable from restricted assets held by the Housing Finance Authority. There were \$1,084 million in new bonds and notes issued during the year on the enterprise funds. Repayments and other reductions in debt outstanding aggregated \$1,939 million for a net reduction of \$855 million. See Note 12 to the basic financial statements for additional information on debt activities during the year.

6. SUBSEQUENT EVENTS

The items below are further discussed in Note 20 to the financial statements.

Adjustable Refunding Bonds — On August 1, 2008, the Bank repurchased the \$267 million outstanding balance of its adjustable refunding bonds as a result of significant increases in the interest rate of these auction rate bonds. The Bank expects to reissue these bonds at a fixed rate during fiscal year 2009.

Capital Fund Modernization Program and Housing Revenue Bonds — On August 1, 2008, the Housing Finance Authority issued the Capital Fund Modernization Program Subordinate Bonds amounting to \$384,475,000 and the Housing Revenue Bonds amounting to \$100,000,000. The proceeds from the issuance will be mainly used to finance a loan to a limited liability company (the "LLC") and pay the costs of issuance. The \$384,475,000 bonds are limited obligations of the Authority, payable primarily by a pledge and assignment of federal housing assistance payments made available by the U.S. Department of Housing and Urban Development. The \$100,000,000 bonds are also limited obligations of the Housing Finance Authority, payable from amounts deposited in escrow accounts with a trustee and the proceeds of a loan to be made by the Housing Finance Authority to the LLC using moneys received as a grant from the Department of Housing of Puerto Rico. Payment of principal, of the Housing Revenue Bonds is also secured by an irrevocable standby letter of credit issued by the Bank. These bonds are considered no-commitment debt and, accordingly, will be excluded, along with the related assets held in trust, from the Housing Finance Authority's financial statements.

Bank's Exposure to American International Group — The Bank, in connection with the issuance of certain bonds issued by the Housing Finance Authority, has entered into certain nonparticipating investment contracts with counterparties that are rated, at the time of the transaction, in accordance with the Bank's investment policies (see Note 4). At June 30, 2008, the Bank had nonparticipating investment contracts outstanding with AIG Matched Funding Corp. (AIGMF) amounting to \$188,931,032.

Subsequent to June 30, 2008, the credit rating of AIGMF was lowered. The Bank is currently evaluating, with its financial advisors and legal counsel, various alternatives for these nonparticipating investment contracts, including but not limited to, unwinding these nonparticipating investment contracts and defease the related bonds issued by the Housing Finance Authority.

Commonwealth's Tax Receivable Anticipation Bonds — On September 9, 2008, October 10, 2008, October 17, 2008, November 26, 2008 and December 1, 2008, the Bank purchased an aggregate principal amount of $1 billion of Tax Receivable Anticipation Bonds of the Commonwealth of Puerto Rico, Series 2008A issued in four separate tranches in the amounts of $300,000,000, $50,000,000, $50,000,000, $250,000,000, and $350,000,000, respectively. These bonds are payable from the revenue generated from the collections of certain Commonwealth's delinquent tax receivables.

7. 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, 2008

ASSETS	Governmental Activities	Business-type Activities	Total
Cash and due from banks	$ -	$ 60,212,101	$ 60,212,101
Federal funds sold		316,620,000	316,620,000
Deposits placed with banks		1,533,888,304	1,533,888,304
Investments and investment contracts		2,635,014,277	2,635,014,277
Loans receivable — net		5,454,425,371	5,454,425,371
Accrued interest receivable		259,623,379	259,623,379
Internal balances	(92,028,224)	92,028,224	-
Restricted assets:			
Cash and due from banks	5,019,954	21,709,954	26,729,908
Deposits placed with banks	49,876,142	32,229,371	82,105,513
Due from federal government	20,936,674		20,936,674
Investments and investment contracts	118,011,025	1,652,836,161	1,770,847,186
Loans receivable — net	2,519,927	6,473,662	8,993,589
Interest and other receivables	3,073,356	3,006,193	6,079,549
Real estate available for sale	625,990	1,354,503	1,980,493
Other assets		8,211,544	8,211,544
Real estate available for sale		58,117,974	58,117,974
Capital assets:			
Land		10,970,990	10,970,990
Other capital assets		16,425,851	16,425,851
Other assets	346,407	44,465,576	44,811,983
TOTAL	108,381,251	12,207,613,435	12,315,994,686
LIABILITIES			
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:			
Demand		2,720,148,159	2,720,148,159
Certificates of deposit:			
Due within one year		4,150,933,733	4,150,933,733
Due in more than one year		132,451,716	132,451,716
Securities sold under agreements to repurchase:			
Due within one year		207,200,000	207,200,000
Due in more than one year		480,000,000	480,000,000
Commercial paper		500,000	500,000
Accrued interest payable		24,955,038	24,955,038
Accounts payable and accrued liabilities:			
Due within one year		60,127,849	60,127,849
Due in more than one year		4,816,117	4,816,117
Allowance for losses on guarantees and letters of credit:			
Due within one year		209,786	209,786
Due in more than one year		2,903,609	2,903,609
Participation agreement payable		26,000,000	26,000,000
Certificates of indebtedness - due in more than one year		11,800,000	11,800,000
Bonds payable - due in more than one year		267,000,000	267,000,000
Notes payable:			
Due within one year	150,768	93,204,456	93,355,224
Due in more than one year	4,811,237	595,624,977	600,436,214
Liabilities payable from restricted assets:			
Accrued interest payable	266,090	2,953,640	3,219,730
Accounts payable and accrued liabilities — due within one year	20,055,607	459,746	20,515,353
Allowance for losses on mortgage loan insurance		441,652	441,652
Bonds and mortgage-backed certificates payable:			
Due within one year		63,447,231	63,447,231
Due in more than one year	-	1,086,809,893	1,086,809,893
Total liabilities	25,283,702	9,931,987,602	9,957,271,304
NET ASSETS (DEFICIT)			
Invested in capital assets		27,396,841	27,396,841
Restricted for:			
Debt service	30,522,788		30,522,788
Affordable housing programs	84,905,875	175,073,146	259,979,021
Mortgage loan insurance		54,385,644	54,385,644
Unrestricted net assets (deficit)	(32,331,114)	2,018,770,202	1,986,439,088
Total net assets	$ 83,097,549	$ 2,275,625,833	$ 2,358,723,382

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, 2008

		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	$ 5,165,094	$ -	$ -	$ -	$ (5,165,094)	$ -	$ (5,165,094)
Housing subsidy programs	144,437,542		10,227,672	133,012,042	(1,197,828)		(1,197,828)
Total governmental activities	149,602,636	-	10,227,672	133,012,042	(6,362,922)	-	(6,362,922)
Business-type activities:							
GDB Operating Fund	381,693,949	35,758,672	453,162,807			107,227,530	107,227,530
Housing Finance Authority	92,053,322	10,904,566	97,610,436			16,461,680	16,461,680
Tourism Development Fund	16,158,839	3,408,443	21,376,701			8,626,305	8,626,305
Public Finance Corporation	7,165,039		7,234,087			69,048	69,048
Capital Fund	67,758	58,516	(4,834,646)			(4,843,888)	(4,843,888)
Development Fund	(5,098,713)	58,176	1,497,737			6,654,626	6,654,626
Other nonmajor	181,592		75,021			(106,571)	(106,571)
Total business-type activities	492,221,786	50,188,373	576,122,143	-	-	134,088,730	134,088,730
Total	$ 641,824,422	$ 50,188,373	$ 586,349,815	$ 133,012,042	(6,362,922)	134,088,730	127,725,808
Special item - early retirement program						(40,242,716)	(40,242,716)
Transfers — net					(4,234,853)	4,234,853	-
Total general revenues and transfers					(4,234,853)	(36,007,863)	40,242,716
Change in net assets					(10,597,775)	98,080,867	87,483,092
Net assets — beginning of year					93,695,324	2,177,544,966	2,271,240,290
Net assets — end of year					$ 83,097,549	$ 2,275,625,833	$ 2,358,723,382

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, 2008

	Affordable Housing Mortgage Subsidy Program-Stage 7	Affordable Housing Mortgage Subsidy Program-Stage 8	Affordable Housing Mortgage Subsidy Program – Stage 9	New Secure Housing Program	The Key for Your Home Program	HUD Programs	Other Nonmajor Governmental Funds	Eliminations	Total Governmental Funds
ASSETS:									
Due from other funds	$ -	$ -	$ -	$ 449,936	$ 30,000	$ -	$ 13,095,155	$ (11,581,631)	$ 1,993,460
Restricted:									
Cash and due from banks	565	1,990	57			5,016,481	861		5,019,954
Deposits placed with banks					37,376,801		12,499,341		49,876,142
Due from federal government				20,936,674					20,936,674
Investments and investment contracts	21,664,576	1,794,399	13,086,036				81,466,014		118,011,025
Loans receivable — net							2,519,927		2,519,927
Due from other funds	2	13,489,597		398,884	1,186,830	656,852	9,034,540		24,766,705
Interest and other receivables	85,389	9,390	5,889	82,086	394,553	2,074,867	421,182		3,073,356
Real estate available for sale							625,990		625,990
TOTAL	$ 21,750,532	$ 15,295,376	$ 13,091,982	$ 21,867,580	$ 38,988,184	$ 7,748,200	$ 119,663,010	$ (11,581,631)	$226,823,233
LIABILITIES:									
Due to other funds	$ 69,505,223	$ -	$ 354,186	$ 44,189,766	$ 117,190	$ 736,688	$ 15,466,967	$ (11,581,631)	$ 118,788,389
Restricted:									
Accounts payable and accrued liabilities	491,298	174,792	92,945	5,315,332	6,043,380	7,011,512	926,348		20,055,607
Deferred revenue				21,018,760					21,018,760
Total liabilities	69,996,521	174,792	447,131	70,523,858	6,160,570	7,748,200	16,393,315	(11,581,631)	159,862,756
FUND BALANCES (DEFICIT):									
Reserved for:									
Long-term loans receivable and other assets							3,145,917		3,145,917
Debt service							27,727,295		27,727,295
Unreserved — special revenue funds	(48,245,989)	15,120,584	12,644,851	(48,656,278)	32,827,614		72,396,483		36,087,265
Total fund balances (deficit)	(48,245,989)	15,120,584	12,644,851	(48,656,278)	32,827,614		103,269,695		66,960,477
TOTAL	$ 21,750,532	$ 15,295,376	$ 13,091,982	$ 21,867,580	$ 38,988,184	$ 7,748,200	$ 119,663,010	$ (11,581,631)	$226,823,233

Amounts reported for governmental activities in the statement of net assets are different because:	
Total fund balance	$ 66,960,477
Deferred bond issue costs that are recorded as expenditures in governmental funds, but are capitalized in the government-wide financial statements	346,407
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	(4,962,005)
Accrued interest payable not due and payable in the current period	(266,090)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds	21,018,760
Net assets of governmental activities	$ 83,097,549

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, 2008

	Affordable Housing Mortgage Subsidy Program-Stage 7	Affordable Housing Mortgage Subsidy Program-Stage 8	Affordable Housing Mortgage Subsidy Program – Stage 9	New Secure Housing Program	The Key for Your Home Program	HUD Programs	Other Nonmajor Governmental Funds	Total Governmental Funds
REVENUES:								
Commonwealth appropriations for repayment of bonds and for housing assistance programs	$ 5,805,790	$ -	$ 5,354,014	$ -	$ -	$ -	$ 529,312	$ 11,689,116
Intergovernmental — federal government						115,587,371		115,587,371
Interest on investments and deposits placed with banks	1,485,685	823,727	548,150	14,910	1,162,433		5,800,649	9,835,554
Interest income on loans							323,063	323,063
Net increase in fair value of investments		19,445					49,610	69,055
Net gain on sale of real estate available for sale							507,337	507,337
Other				281,031	2,550,737		283,098	3,114,866
Total revenues	7,291,475	843,172	5,902,164	295,941	3,713,170	115,587,371	7,493,069	141,126,362
EXPENDITURES:								
Current:								
General government and other	7,792	9,510				4,993,847	153,945	5,165,094
Housing assistance programs	1,919,216	849,825	837,266	6,080,054	12,790,626	110,593,524	5,520,420	138,590,931
Credit for loan losses							(246,669)	(246,669)
Debt service:								
Principal	5,236,530							5,236,530
Interest	3,596,035		44,198	1,960,423			779,294	6,379,950
Total expenditures	10,759,573	859,335	881,464	8,040,477	12,790,626	115,587,371	6,206,990	155,125,836
Excess (deficiency) of revenues over (under) expenditures	(3,468,098)	(16,163)	5,020,700	(7,744,536)	(9,077,456)	-	1,286,079	(13,999,474)
Other financing sources (uses):								
Transfers-in					38,850,091		39,041,064	77,891,155
Transfers-out		(79,534)	(546,956)				(81,499,518)	(82,126,008)
Total other financing sources (uses)	-	(79,534)	(546,956)	-	38,850,091	-	(42,458,454)	(4,234,853)
Net change in fund balance	(3,468,098)	(95,697)	4,473,744	(7,744,536)	29,772,635	-	(41,172,375)	(18,234,327)
Fund balances (deficit) — beginning of year	(44,777,891)	15,216,281	8,171,107	(40,911,742)	3,054,979		144,442,070	85,194,804
Fund balances (deficit) — end of year	$ (48,245,989)	$ 15,120,584	$ 12,644,851	$ (48,656,278)	$ 32,827,614	$ -	$ 103,269,695	$ 66,960,477

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, 2008

Amounts reported for governmental activities in the statement of activities are different because:	
Net change in fund balances — total governmental funds	$ (18,234,327)
Repayment of the principal of long-term debt consumes the current financial resources of governmental funds	5,236,530
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	303,170
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	2,113,352
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	$ (10,597,775)

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, 2008

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Other Nonmajor	Eliminations	Total
ASSETS									
Current assets:									
Cash and due from banks	$ 59,818,358	$ 4,374,167	$ 11,368,083	$ 1,259,286	$ -	$40,238,533	$2,404,865	$ (59,251,191)	$ 60,212,101
Federal funds sold	316,620,000								316,620,000
Deposits placed with banks	1,505,000,000	84,096,979	45,000,000					(100,208,675)	1,533,888,304
Investments and investment contracts	2,007,599,088	25,500	47,851,208		320,563				2,055,796,359
Loans receivable — net	802,644,635	7,329,038	1,053,000	2,612,187				(3,485,186)	810,153,674
Accrued interest receivable	258,507,954	1,486,716	1,607,585	6,297,786	635	54,855	2,689	(8,334,841)	259,623,379
Other current receivables	21,794,518	4,695,168	13,124			26,748			26,529,558
Other current assets	1,017,745	182,803	289,849						1,490,397
Due from governmental funds	112,101,375	6,687,012							118,788,387
Restricted:									
Cash and due from banks		22,230,693						(520,739)	21,709,954
Deposits placed with banks		359,570,687						(327,341,316)	32,229,371
Investments and investment contracts	34,996,500	341,836,677							376,833,177
Loan receivable — net		616,236							616,236
Accrued interest receivable		13,759,585						(10,753,392)	3,006,193
Total current assets	5,120,100,173	846,891,261	107,182,849	10,169,259	321,198	40,320,136	2,407,554	(509,895,340)	5,617,497,090
Noncurrent assets:									
Restricted:									
Investments and investment contracts	705,854,918	759,079,097						(188,931,031)	1,276,002,984
Loans receivable — net		5,857,426							5,857,426
Real estate available for sale		1,354,503							1,354,503
Other assets		8,211,544							8,211,544
Investments and investment contracts	583,317,273	17,628,800	21,400,179		82,438,465	3,378,700		(128,945,499)	579,217,918
Loans receivable — net	4,399,777,543	191,914,708	265,049,341	101,915,460				(314,385,355)	4,644,271,697
Real estate available for sale	56,323,019	1,794,955							58,117,974
Capital assets:									
Land	10,970,990								10,970,990
Other capital assets	11,879,538	4,546,313							16,425,851
Other assets	7,565,617	8,880,004							16,445,621
Total noncurrent assets	5,775,688,898	999,267,350	286,449,520	101,915,460	82,438,465	3,378,700	-	(632,261,885)	6,616,876,508
Total assets	$10,895,789,071	$1,846,158,611	$393,632,369	$112,084,719	$82,759,663	$43,698,836	$2,407,554	$(1,142,157,225)	$12,234,373,598

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, 2008

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Other Nonmajor	Eliminations	Total
LIABILITIES									
Current liabilities:									
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:									
Demand	$ 2,780,562,925	$ -	$ -	$ -	$ -	$ -	$ -	$ (60,414,766)	$ 2,720,148,159
Certificates of deposit	4,578,483,723							(427,549,990)	4,150,933,733
Securities sold under agreements to repurchase	207,200,000								207,200,000
Commercial paper	500,000								500,000
Accrued interest payable	36,027,309		854,964	7,160,998				(19,088,233)	24,955,038
Accounts payable and accrued liabilities	38,772,134	15,445,748	1,637,512	2,749	10,231	3,614,416	2,224	642,835	60,127,849
Allowance for losses on guarantees and letters of credit						209,786			209,786
Due to governmental funds	24,766,706	1,993,457							26,760,163
Notes payable	93,204,456	-	873,000	2,612,186				(3,485,186)	93,204,456
Total current liabilities payable from unrestricted assets	7,759,517,253	17,439,205	3,365,476	9,775,933	10,231	3,824,202	2,224	(509,895,340)	7,284,039,184
Current liabilities payable from restricted assets:									
Accrued interest payable		2,953,640							2,953,640
Accounts payable and accrued liabilities		459,746							459,746
Bonds and mortgage-backed certificates payable		63,447,231							63,447,231
Total current liabilities	7,759,517,253	84,299,822	3,365,476	9,775,933	10,231	3,824,202	2,224	(509,895,340)	7,350,899,801
Noncurrent liabilities:									
Certificates of deposits, principally from the Commonwealth of Puerto Rico and its public entities	321,382,747							(188,931,031)	132,451,716
Certificates of indebtedness	11,800,000								11,800,000
Securities sold under agreements to repurchase	480,000,000								480,000,000
Allowance for losses on guarantees and letters of credit	1,000,000		1,270,052			633,557			2,903,609
Accounts payable and accrued liabilities	2,451,157						2,364,960		4,816,117
Participation agreement payable			26,000,000						26,000,000
Bonds and notes payable	862,624,977		213,061,464	101,323,891				(314,385,355)	862,624,977
Noncurrent liabilities payable from restricted assets:									
Allowance for losses on mortgage loan insurance		441,652							441,652
Bonds and mortgage-backed certificates payable		1,215,755,392						(128,945,499)	1,086,809,893
Total noncurrent liabilities	1,679,258,881	1,216,197,044	240,331,516	101,323,891	-	633,557	2,364,960	(632,261,885)	2,607,847,964
Total liabilities	9,438,776,134	1,300,496,866	243,696,992	111,099,824	10,231	4,457,759	2,367,184	(1,142,157,225)	9,958,747,765
NET ASSETS									
Invested in capital assets	22,850,528	4,546,313							27,396,841
Restricted for:									
Mortgage loan insurance		54,385,644							54,385,644
Affordable housing programs		175,073,146							175,073,146
Unrestricted	1,434,162,409	311,656,642	149,935,377	984,895	82,749,432	39,241,077	40,370		2,018,770,202
Total net assets	1,457,012,937	545,661,745	149,935,377	984,895	82,749,432	39,241,077	40,370	-	2,275,625,833
Total liabilities and net assets	$ 10,895,789,071	$ 1,846,158,611	$ 393,632,369	$ 112,084,719	$ 82,759,663	$ 43,698,836	$ 2,407,554	$ (1,142,157,225)	$ 12,234,373,598

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, 2008

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Other Nonmajor	Total
OPERATING REVENUES:								
Investment income:								
Interest income on federal funds sold	$ 47,676,634	$ -	$ -	$ -	$ -	$ -	$ -	$ 47,676,634
Interest income on deposits placed with banks	80,310,347	28,576,328	1,957,465	38,550		1,444,241	75,021	112,401,952
Interest and dividend income on investments and investment contracts	66,781,549	57,991,596	2,996,645		554,712	53,496		128,377,998
Net increase (decrease) in fair value of investments	4,202,069	(764,145)	783,141		(5,389,358)			(1,168,293)
Total investment income (loss)	198,970,599	85,803,779	5,737,251	38,550	(4,834,646)	1,497,737	75,021	287,288,291
Interest income on loans receivable:								
Public sector	254,192,208			7,195,537				261,387,745
Private sector		11,806,657	15,639,450					27,446,107
Total interest income on loans receivable	254,192,208	11,806,657	15,639,450	7,195,537	-	-	-	288,833,852
Total investment income (loss) and interest income on loans receivable	453,162,807	97,610,436	21,376,701	7,234,087	(4,834,646)	1,497,737	75,021	576,122,143
Noninterest income:								
Fiscal agency fees	20,210,134	277,890						20,488,024
Commitment, guarantee and other service fees	4,811,842	6,493,816	2,642,361			58,176		14,006,195
Mortgage insurance premiums		3,052,525						3,052,525
Net gain on sale of real estate available for sale	4,296,557	232,106						4,528,663
Gain on sale of loans		24,776						24,776
Other income	6,440,139	823,453	766,082		58,516			8,088,190
Total noninterest income	35,758,672	10,904,566	3,408,443	-	58,516	58,176	-	50,188,373
Total operating revenues (loss)	488,921,479	108,515,002	24,785,144	7,234,087	(4,776,130)	1,555,913	75,021	626,310,516
OPERATING EXPENSES:								
Provision for loan losses		1,770,002	323,924					2,093,926
Interest expense:								
Deposits	229,712,412							229,712,412
Securities sold under agreements to repurchase	23,917,723							23,917,723
Commercial paper	10,678,317							10,678,317
Certificates of indebtedness	487,903							487,903
Bonds, notes and mortgage-backed certificates payable	75,839,338	71,027,429	13,472,952	7,160,997				167,500,716
Total interest expense	340,635,693	71,027,429	13,472,952	7,160,997	-	-	-	432,297,071
Noninterest expenses:								
Salaries and fringe benefits	25,484,675	12,918,702					59,156	38,462,533
Depreciation and amortization	1,579,553	689,093						2,268,646
Occupancy and equipment costs	4,153,774	1,433,690	60			-		5,587,524
Legal and professional fees	2,899,997	2,341,598	321,305	2,750	34,438	56,858	41,053	5,697,999
Office and administrative	683,547	451,863			33,320			1,168,730
Subsidy and trustee fees	52,190	338,950						391,140
Provision (credit) for losses on guarantees and letters of credit			(192,872)			1,242,721		1,049,849
Provision for amount due from Puerto Rico Department of Housing		227,993						227,993
Other	3,546,037	854,002	508,254	1,292	-	(6,398,292)	81,383	(1,407,324)
Total noninterest expenses	38,399,773	19,255,891	636,747	4,042	67,758	(5,098,713)	181,592	53,447,090
Total operating expenses (income)	379,035,466	92,053,322	14,433,623	7,165,039	67,758	(5,098,713)	181,592	487,838,087
OPERATING INCOME (LOSS)	109,886,013	16,461,680	10,351,521	69,048	(4,843,888)	6,654,626	(106,571)	138,472,429
CONTRIBUTIONS TO COOPERATIVE DEVELOPMENT INVESTMENT TRUST FUND AND OTHERS	(2,658,483)		(1,725,216)					(4,383,699)
SPECIAL ITEM — Early retirement program	(31,405,694)	(8,837,022)						(40,242,716)
TRANSFERS-IN		27,597,448						27,597,448
TRANSFERS-OUT	-	(23,362,595)	-	-	-	-	-	(23,362,595)
CHANGE IN NET ASSETS	75,821,836	11,859,511	8,626,305	69,048	(4,843,888)	6,654,626	(106,571)	98,080,867
NET ASSETS — Beginning of year	1,381,191,101	533,802,234	141,309,072	915,847	87,593,320	32,586,451	146,941	2,177,544,966
NET ASSETS — End of year	$ 1,457,012,937	$ 545,661,745	$ 149,935,377	$ 984,895	$ 82,749,432	$ 39,241,077	$ 40,370	$ 2,275,625,833

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - ENTERPRISE FUNDS
FOR THE YEAR ENDED JUNE 30, 2008

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Other Nonmajor	Eliminations	Total
CASH FLOWS FROM OPERATING ACTIVITIES:									
Cash received from interest on housing program loans	$ -	$ 11,541,289	$ -	$ -	$ -	$ -	$ -	$ -	$ 11,541,289
Cash paid for housing program loans originated		(47,340,071)							(47,340,071)
Principal collected on mortgage and construction loans		13,714,877							13,714,877
Proceeds from sale of housing program loans		5,535,982							5,535,982
Guarantee fees collected			2,868,772			31,428			2,900,200
Payment of guarantees						(429,797)			(429,797)
Cash received from other operating non-interest revenues	36,819,042	4,013,805	1,206,456		58,516				42,097,819
Due from governmental funds	(57,930,756)	(2,491,914)							(60,422,670)
Cash payments for other operating non-interest expenses	(2,702,930)	(6,102,534)	(1,814,348)	(3,848)	(87,154)	(65,354)	(49,794)	(1,616,107)	(12,442,069)
Cash received from mortgage loans insurance premiums		3,052,525							3,052,525
Payment for early retirement program	(20,963,074)	(7,515,569)							(28,478,643)
Cash payments for salaries and fringe benefits	(26,387,365)	(12,994,171)					(59,156)		(39,440,692)
Net cash provided by (used in) operating activities	(71,165,083)	(38,585,781)	2,260,880	(3,848)	(28,638)	(463,723)	(108,950)	(1,616,107)	(109,711,250)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:									
Contributions to others	(3,672,434)		(725,216)						(4,397,650)
Transfer-in		27,597,448							27,597,448
Transfer-out		(23,362,595)							(23,362,595)
Net increase (decrease) in:									
Deposits	1,522,683,381							22,856,671	1,545,540,052
Commercial paper	(575,361,000)								(575,361,000)
Proceeds from issuance of securities sold under agreements to repurchase	587,204,000								587,204,000
Payment of securities sold under agreements to repurchase	(355,004,000)								(355,004,000)
Proceeds from issuance of bonds and notes	869,767,600	200,000,000	39,229,669					(39,229,669)	1,069,767,600
Repayments of bonds and notes	(1,877,800,000)	(99,455,839)	(10,266,376)	(198,329,030)				208,599,551	(1,977,251,694)
Payment of bond issue costs		(2,738,407)							(2,738,407)
Interest paid	(347,367,343)	(34,776,325)	(11,865,527)	(20,452,988)				(14,033,685)	(428,495,868)
Net cash provided by (used in) noncapital financing activities	(179,549,796)	67,264,282	16,372,550	(218,782,018)				178,192,868	(136,502,114)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES — Purchase of capital assets	(2,458,973)	(1,557,181)							(4,016,154)

See accompanying notes to basic financial statements.

(Continued)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - ENTERPRISE FUNDS
FOR THE YEAR ENDED JUNE 30, 2008

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Other Nonmajor	Eliminations	Total
CASH FLOWS FROM INVESTING ACTIVITIES:									
Net decrease (increase) in:									
Federal funds sold	$ 628,880,000	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 628,880,000
Deposits placed with banks	315,057,870	(2,588,934)	(3,765,108)					6,988,217	315,692,045
Purchases of investments	(5,093,621,769)	(244,392,640)	(17,442,429)		(5,000,000)	(3,378,700)		7,765,468	(5,356,070,070)
Proceeds from sales and redemptions of investments	3,000,007,101	139,429,596	16,920,918		5,000,000			(38,035,579)	3,123,322,036
Interest and dividends received on investments	177,621,684	76,194,999	4,511,037		28,638	1,603,620	81,529	(217,201)	259,824,306
Interest received on other than housing program loans	465,462,637		14,578,994	20,497,096				14,256,318	514,795,045
Origination of other than housing program loans	(2,822,621,097)		(43,640,152)					39,229,669	(2,827,031,580)
Principal collected on other than housing program loans	3,622,458,463		16,468,995	198,329,030				(208,599,551)	3,628,656,937
Disbursements for acquisition and improvements to real estate held for sale	(3,905,160)	(801,694)							(4,706,854)
Proceeds from sale of real estate held for sale	17,901,600	1,148,627							19,050,227
Net change in other assets		51,917							51,917
Net cash provided by (used in) investing activities	307,241,329	(30,958,129)	(12,367,745)	218,826,126	28,638	(1,775,080)	81,529	(178,612,659)	302,464,009
Net change in cash and due from banks	54,067,477	(3,836,809)	6,265,685	40,260		(2,238,803)	(27,421)	(2,035,898)	52,234,491
Cash and due from banks — beginning of year	5,750,881	30,441,669	5,102,398	1,219,026		42,477,336	2,432,286	(57,736,032)	29,687,564
Cash and due from banks — end of year	$ 59,818,358	$ 26,604,860	$ 11,368,083	$ 1,259,286	$ -	$ 40,238,533	$ 2,404,865	$ (59,771,930)	$ 81,922,055
Reconciliation to enterprise funds balance sheet:									
Cash – unrestricted	$ 59,818,358	$ 4,374,167	$ 11,368,083	$ 1,259,286	$ -	$ 40,238,533	$ 2,404,865	$ (59,251,191)	$ 60,212,101
Cash – restricted		22,230,693						(520,739)	21,709,954
Total cash at year end	$ 59,818,358	$ 26,604,860	$ 11,368,083	$ 1,259,286	$ -	$ 40,238,533	$ 2,404,865	$ (59,771,930)	$ 81,922,055

See accompanying notes to basic financial statements

(Continued)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - ENTERPRISE FUNDS
FOR THE YEAR ENDED JUNE 30, 2008

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Other Nonmajor	Eliminations	Total
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:									
Operating income (loss)	$ 109,886,013	$ 16,461,680	$ 10,351,521	$ 69,048	$ (4,843,888)	$ 6,654,628	$ (106,571)	$ -	$ 138,472,431
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:									
Investment income	(194,768,530)	(86,567,924)	(4,954,110)	(38,550)	(554,712)	(1,497,737)	(75,021)		(288,456,584)
Interest income on other than housing program loans	(254,192,208)		(15,639,450)	(7,195,537)					(277,027,195)
Interest expense	340,635,693	71,027,429	13,472,952	7,160,996					432,297,070
Provision for loan losses		1,770,002	323,924						2,093,926
Provision (credit) for losses on guarantees and letters of credit			(192,872)			1,242,721			1,049,849
Payments of guarantees						(429,797)			(429,797)
Early retirement program	(31,405,694)	(8,837,022)							(40,242,716)
Provision (credit) for losses on other assets	(839,879)	227,993	609,365						(2,521)
Net decrease (increase) in fair value of investment	(4,202,069)	764,145	(783,141)		5,389,358				1,168,293
Net increase in fair value of derivatives	(29,093,604)								(29,093,604)
Net decrease in fair value of hedged item	24,246,329								24,246,329
Net gain on sale of real estate held for sale	(4,296,557)	(232,106)							(4,528,663)
Provision for losses on real estate held for sale		252,511							252,511
Net gain on sales of housing program loans		(24,776)							(24,776)
Loss on disposition of capital assets	57,347								57,347
Depreciation and amortization	1,579,553	689,093							2,268,646
Accretion of deferred loan fees and costs		(327,395)							(327,395)
Changes in operating assets and liabilities:									
Housing program loans receivable		(47,340,071)							(47,340,071)
Collections of mortgage and construction loans		13,714,877							13,714,877
Proceeds from sale of housing program loans		5,535,982							5,535,982
Interest receivable on housing program loans		(265,369)							(265,369)
Decrease (increase) in other assets	12,366,980	(3,253,957)	78,185			(26,748)	831		9,165,291
Decrease in due from governmental funds	(57,930,756)	(2,491,914)							(60,422,670)
Decrease in due to Commonwealth of Puerto Rico	(1,013,951)								(1,013,951)
Increase (decrease) in other liabilities	17,806,250	311,041	(1,005,494)	195	(19,396)	(6,406,790)	71,811	(1,616,107)	9,141,510
Net cash provided by (used in) operating activities	$ (71,165,083)	$ (38,585,781)	$ 2,260,880	$ (3,848)	$ (28,638)	$ (463,723)	$ (108,950)	$ (1,616,107)	$ (109,711,250)

See accompanying notes to basic financial statements.

(Continued)

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

STATEMENT OF CASH FLOWS - ENTERPRISE FUNDS
FOR THE YEAR ENDED JUNE 30, 2008

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Public Finance Corporation	Capital Fund	Development Fund	Other Nonmajor	Eliminations	Total
Noncash investing and noncapital financing activities:									
Accretion of discount on investment securities and									
capitalized interest on investment securities	$ 22,274,732	$ 9,721,244	$ -	$ -	$ 541,222	$ -	$ -	$ (9,721,244)	$ 22,815,954
Capitalized interest on loans and other	(1,931,863)	564,299							(1,367,564)
Loan to foreclosed real estate			609,365						609,365
Transfer of investments to mortgage loans receivable		5,273,323							5,273,323
Transfer of mortgage loans receivable to real estate held for sale		1,522,502							1,522,502
Capital assets acquired that have not been paid		1,181,433							1,181,433
Bond issue costs that have not been paid		16,309							16,309
Accretion of discount on:									
Deposits	9,721,244							(9,721,244)	
Bonds payable	10,271,537	33,704,251						(9,746,406)	34,229,382
Increase (decrease) in fair value of investments	4,202,069	(764,145)	783,141		(5,389,358)			(9,746,406)	(10,914,699)
Increase in fair value of derivatives	(29,093,604)								(29,093,604)
Decrease in fair value of hedged item	30,614,056								30,614,056
Amortization of bond issue cost (included in interest expense)	1,932,715								1,932,715
Amortization of deferred loss		395,920							395,920

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. The Bank's charter, as amended, allows the Bank to invest in securities issued by any corporate entity engaged in the economic development of Puerto Rico, as well as to guarantee loans and other obligations incurred by public and private entities.

Pursuant to Act No. 82 of June 16, 2002, which amended the Bank's enabling legislation, the Bank may transfer annually to the General Fund of the Commonwealth (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. The board of directors of the Bank approved not to make this transfer for the year ended June 30, 2008.

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 mortgaged-backed securities collateralized by mortgage loans on properties located in Puerto Rico 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, 2008, management, with the consent of the Bank's board of directors, deemed convenient to defer its implementation, and in the meantime elected a passive management considering it a more cost-effective mechanism.

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 Public Insurance Office of the Department of the Treasury. Insurance coverage is updated annually to account for changes in operating risk. For the last three years insurance settlements have not exceeded the amount of coverage.

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.

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, the Bank has elected to apply all applicable statements and interpretations issued by the Financial Accounting Standards Board, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures in accounting and reporting for its enterprise funds operations and government-wide activities, unless they conflict with GASB pronouncements.

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 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 and interest earned on investment securities. 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, except for those governmental nonmajor funds, which management has elected to present separately in the financial statements. 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 Statements — 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, 2008, is 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 7, 8 and 9)** — These special revenue funds are used to account for the proceeds of specific revenue sources under Stages 7, 8 and 9 of the Affordable Housing Mortgage Subsidy Program (AHMSP) that are legally restricted for expenditures to promote the origination of mortgage loans by financial institutions in the private sector to low and moderate-income families. Under these stages, the Housing Finance Authority commits to provide subsidy for the down payment and/or the principal and interest payments on mortgage loans originated under a predetermined schedule of originations and, in the case of Stage 9, to acquire such mortgages in the form of mortgage-backed securities issued by the financial institutions. Loans originated, as well as servicing, are kept by the originating financial institution. There was no open schedule of originations under these stages as of June 30, 2008.

- **New Secure Housing Program** — This special revenue fund is used to account for federal and local resources directed to plan, coordinate, and develop the construction of new housing units as a replacement for those destroyed by Hurricane Georges in 1998 and to attend the housing needs of those families living in hazard prone areas.

- **The Key for Your Home Program** — This special revenue fund was created to provide subsidy to low and moderate-income families of costs directly related to the purchase and rehabilitation of housing units, subject to certain maximum amounts.

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

- **Affordable Housing Mortgage Subsidy Programs (Stages 2, 3 and 6)** — These special revenue funds are similar to Stages 7 and 8 described above. There was no open schedule of originations under these stages as of June 30, 2008.

- **Affordable Housing Mortgage Subsidy Program (Stages 10 and 11)** — These special revenue funds are similar to Stage 9 described above. At June 30, 2008, the Housing Finance Authority had a commitment, expiring on September 1, 2009, for the acquisition of mortgage-backed securities amounting to approximately $200 million.

- **Affordable Housing Mortgage Subsidy Program – Act No. 124** — This special revenue fund accounts for excess subsidy funds as well as accumulated net assets released periodically from arbitrage structures used to provide housing assistance.

- **Special Obligation Refunding Bonds - Debt Service** — This debt service fund accounts for the funds and assets transferred by the Commonwealth through legislative appropriations and by the liquidator of the former Corporación de Renovación Urbana y Vivienda (CRUV).

- **Affordable Housing Mortgage Subsidy Mortgage Backed Certificates** — This special revenue fund is used to account for specific revenue sources used to provide subsidy for the mortgages underlying the mortgage-backed securities held as collateral for the mortgage-backed certificates issued in fiscal year 2007.

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, advances or guarantees and all general and administrative expenses, among others. 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 agent, with whom the agreement is transacted. There were no securities purchased under agreements to resell outstanding at June 30, 2008.

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 (guaranteed investment contracts), which are carried at cost; and investment positions in 2a-7 like external investment pools, which are carried at the pools' share price. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers. 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 an 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) it is not covered by a formal commitment from the Commonwealth; and (d) it has no designated collateral or such collateral is insufficient. Once a loan is placed in nonaccrual status, all accrued interest receivable is reversed from interest income. Interest income on nonaccrual loans is thereafter recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when management has adequate evidence to believe that the loans will be performing as contracted.

The allowance for loan losses is established through provisions recorded in the fund financial statements. This 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 collection of the principal is unlikely. Recoveries of amounts previously charged off are credited to the respective allowance. Because of uncertainties inherent in the estimation process, management estimate of credit losses in the outstanding loans receivable portfolios and the related allowance may change in the near future.

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 for predominantly in the same manner as nonaccrual loans.

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

Loans to the Commonwealth of Puerto Rico, its agencies and instrumentalities amounted to approximately \$3,997,471,000 or 32% of the Bank's total assets as of June 30, 2008. These loans are expected to be collected from appropriations from, bond issuances of, or revenues generated by, the Commonwealth of Puerto Rico, its agencies and instrumentalities. The Commonwealth's recurring expenditures have exceeded its recurring revenues during the past six years and its credit ratings have been lowered. The collectibility of these loans may be affected by budgetary constraints, the fiscal situation and the credit rating of the Commonwealth of Puerto Rico, its agencies and instrumentalities, and their ability to generate sufficient funds from taxes, charges and/or bond issuances. Significant negative changes in these factors may have an adverse impact on the Bank's financial condition, liquidity, funding sources, and results of operations.

Management believes that no losses will be incurred by the Bank with respect to principal and interest on most of its loans to the public sector (including municipalities), and, as a result, 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 of the Commonwealth (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 to any governmental entity for which the source of repayment consists of appropriations from the Commonwealth's general fund without first obtaining the approval of the Legislature, except for (i) loans up to an aggregate amount of \$100,000,000 as long as, among other things, the 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. In addition, on May 13, 2006, the Legislature enacted Act No. 91 that established the *Dedicated Sales Tax Fund,* known as FIA by the acronym of its Spanish name (the "FIA Fund"). Act No. 91 provides that the first one percent of the Commonwealth's share of the sales and consumption tax ("Pledged Sales Tax") will be used to repay certain obligations of the Commonwealth that were outstanding at June 30, 2006, payable to the Bank and the Public Finance Corporation, generally referred to as extra-constitutional debt, including approximately \$2.8 billion of loans due by the Commonwealth and certain of its instrumentalities to the Bank.

Act No. 91 was amended by Act No. 291, enacted on December 26, 2006, and by Act No. 56 enacted on July 6, 2007, to create the Puerto Rico Sales Tax Financing Corporation (the "Sales Tax Corporation") as an independent governmental instrumentality that will own and hold the FIA Fund for the purpose of financing the payment, retirement or defeasance of the extra-constitutional debt. Pursuant to Act No. 91, as amended, the Sales Tax Corporation issued Bonds Series A and B on July 31, 2007 (the "Sales Tax Corporation Bonds") for the payment and retirement of a portion of the extra-constitutional debt outstanding at June 30, 2006. From the proceeds of the Sales Tax Corporation Bonds, the Bank received \$1.7 billion on July 31, 2007 in partial payment of the outstanding extra- constitutional debt. The Sales Tax Corporation Bonds and any additional bonds issued by the Sales Tax Corporation will be payable from and secured by the Pledged Sales Tax.

Also, loans granted to finance capital improvement programs of certain public entities are generally repaid from the proceeds of future bond issuances of these public entities or the Commonwealth. The public corporations and the Commonwealth have never defaulted on their respective bonds. Although management of the Bank believes that no additional losses of principal and interest will be incurred by the Bank with respect to loans outstanding to the public sector at June 30, 2008, there can be no assurance that the Director of the OMB will include amounts for loan repayments 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, or that future collections of the Pledged Sales Tax will be sufficient to cover the outstanding amount of extra-constitutional debt at June 30, 2008. Also, the participation of certain public entities in the bond issuance market has been delayed waiting for the credit rating of the issuer to improve or for more favorable market conditions. 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, Pledged Sales Tax, 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 amounting to approximately $401 million at June 30, 2008 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. In addition, Act. No. 80, enacted on July 29, 2007, provides that a portion of the municipal sales tax will be deposited in special accounts with the Bank for the purpose of granting loans to municipalities. The funds available in such accounts increase the borrowing capacity of the corresponding municipality. As of June 30, 2008, loans to municipalities repayable from these accounts amounted to approximately $270 million.

Loans recorded in the governmental funds are presented at the outstanding unpaid principal balance reduced by an 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 loan losses. Any deficiency in the estimated allowance requirement is recorded as an additional provision to the allowance for loan losses.

The concentration of risk in the guarantees and letters of credit issued, predominantly those issued by the Tourism Development Fund (small number of large guarantees, geographical concentration in Puerto Rico, industry concentration in hotel and tourism), as well as 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. As of June 30, 2008 there were no outstanding claims for reimbursements.

Debt Issue Costs — Debt issue costs are deferred and amortized, as a component of interest expense, over the term of the related debt using the effective interest method, or a systematic and rational method that approximates the interest method. 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 in lieu of payment and through foreclosure proceedings. It also includes loans that are treated as if the underlying collateral had been foreclosed because the Bank has taken possession of the collateral, even though legal foreclosure or repossession proceedings have not taken place. Those properties are carried at the lower of cost or fair value, which is established by a third party professional assessment or based upon an appraisal, minus estimated costs to sell. At the time of acquisition of properties in full or in partial satisfaction of loans, any excess of the loan balance over the fair value of the properties minus estimated costs to sell is charged against the allowance for loan losses. Subsequent declines in the value of real estate available for sale are charged to expenditure/expense. Gain or loss on sale related to foreclosed real estate available for sale is included within noninterest 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 amount is, 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. Because of uncertainties inherent in the estimation process, management's estimate of losses in the outstanding loans guarantee portfolio and the related allowance may change in the near future.

Capital Assets — Capital assets, which include premises and equipment, are stated at cost less accumulated depreciation and amortization, and are reported in the business-type activities column 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 of 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. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Costs of maintenance and repairs, which do not improve or extend the lives of the respective assets, are charged to expense as incurred.

Estimated useful lives are as follows:

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

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 due at June 30 and expected to be collected within 120 days thereafter to pay obligations due at June 30. Deferred revenues at the government-wide level arise only when the Bank receives resources before it has a legal claim to them.

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. 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 — GASB No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, 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 of Receivables — Transfers of receivables are accounted and reported as a sale if the Bank's continuing involvement with those receivable is effectively terminated. This approach distinguishes transfers of receivables that are sales from transfers that are collateralized borrowings.

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

The 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 — 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 hedged 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.

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, 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 depends on the effectiveness of the hedge. To the extent these derivatives are effective in offsetting the variability of the hedged cash flows, the changes in the derivatives' fair value are reported in the statement of revenues, expenses, and changes in net assets. The Bank records 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.

Derivative-like instruments embedded in contracts that meet certain criteria 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 or statement of activities.

Effective July 1, 2008, the Bank will follow the provisions of GASB No. 53, *Accounting and Financial Reporting for Derivative Instruments*. At June 30, 2008, there were no derivative instruments outstanding.

Future Adoption of Accounting Pronouncements — The GASB has issued the following Statements:

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which is effective for financial statements for periods beginning after December 15, 2007.

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which is effective for financial statements for periods beginning after June 15, 2009.

GASB Statement No. 52, *Land and Other Real Estates Held as Investments by Endowments,* which is effective for financial statements for periods beginning after June 15, 2008.

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is effective for periods beginning after June 15, 2009.

Adoption of these statements is not expected to have a material impact on the Bank's basic financial statements.

3. CASH AND DUE FROM BANKS, FEDERAL FUNDS SOLD, AND DEPOSITS PLACED WITH BANKS

The table presented below discloses the level of custodial credit risk assumed by the Bank at June 30, 2008. 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 and federal funds sold establish maximum exposure limits for each institution based on the institution's capital, financial condition and credit rating assigned by nationally recognized rating agencies. Deposits placed with banks of approximately $1,616 million mature within one year. Federal funds sold mature overnight and no collateral is required. As of June 30, 2008, $2,012,883,443 of the depository bank balance of $2,013,407,876 was uninsured and uncollateralized as follows:

	Carrying Amount	Depository Bank Balance	Amount Uninsured and Uncollateralized
Cash and due from banks	$ 86,942,009	$ 80,834,059	$ 80,269,626
Deposits placed with banks	1,615,993,817	1,615,953,817	1,615,993,817
Federal funds sold	316,620,000	316,620,000	316,620,000
Total	$ 2,019,555,826	$ 2,013,407,876	$ 2,012,883,443

Reconciliation to the government-wide statement of net assets:

Unrestricted:	
Cash and due from banks	$ 60,212,101
Federal funds sold	316,620,000
Deposits placed with banks	1,533,888,304
Total unrestricted	1,910,720,405
Restricted:	
Cash and due from banks	26,729,908
Deposits placed with banks	82,105,513
Total restricted	108,835,421
Total	$ 2,019,555,826

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 of deposit 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 its equivalent 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. Any exceptions must be approved by the Bank's board of directors. The investment policies also provide that purchases and sales of investment securities shall be made using the delivery 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, 2008. 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	$ 14,997,389	$ -	$ -	$ -	$ 14,997,389
U.S. Treasury notes	9,673,984				9,673,984
U.S. sponsored agencies notes:					
Federal Home Loan Bank (FHLB)	34,996,500	404,195,020			439,191,520
Federal Farm Credit Bank ("FFCB")		4,352,517			4,352,517
Mortgage and asset-backed securities:					
Government National Mortgage Association (GNMA)	25,500	2,508,960	4,010,216	504,134,214	510,678,890
Federal National Mortgage Association (FNMA)		668,039	144,470,668	18,274,456	163,413,163
Federal Home Mortgage Corporation (FHLMC)	12,096	32,855	19,041,544	174,094,307	193,180,802
Other	1,147,915	4,100,153			5,248,068
Corporate debt:					
Popular North America	4,850,000				4,850,000
Morgan Stanley				26,739,250	26,739,250
General Electric		5,087,900			5,087,900
Pfizer, Inc.	2,002,200				2,002,200
Other				13,800,000	13,800,000
External investment pools — Fixed-income securities	2,261,006,501				2,261,006,501
Nonparticipating investment contracts:					
CDC Funding	141,824,581			32,950,236	174,774,817
American International Group				188,931,032	188,931,032
Other				83,757,582	83,757,582
U.S. municipal notes				45,100,000	45,100,000
Commonwealth agency bonds		3,530,000		195,745,000	199,275,000
Total investments	$ 2,470,536,666	$ 424,475,444	$ 167,522,428	$ 1,283,526,077	4,346,060,615
External investment pools:					
Equity securities:					
Russell 1000 Growth Common Trust Fund					40,976,675
Global Opportunities Capital Appreciation Fund					14,722,540
Equity securities — Grupo Hima San Pablo					3,378,700
Other					722,933
Total					$ 4,405,861,463
Reconciliation to the government-wide statement of net assets					
Unrestricted investments and investment contracts					$ 2,635,014,277
Restricted investments and investment contracts					1,770,847,186
Total					$ 4,405,861,463

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 $38,048,333 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. The fair value of the pool is the same as the value of the pool shares.

At June 30, 2008, the Bank's $45,627,150 investment in corporate debt with maturity over one year bears a fixed interest rate. Also, at June 30, 2008, approximately 63% of the Bank's investments in mortgage and asset-backed securities were held by trustees in connection with bonds issued by the Housing Finance Authority, the terms of which generally provide for early redemption of the bonds if the securities are early repaid.

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, 2008 are as follows:

	Credit Risk				
	Rating				
Securities type	**AAA to A**	**BBB+**	**BBB-**	**Not Rated**	**Total**
U.S. sponsored agencies notes:					
FHLB	$ 439,191,520	$ -	$ -	$ -	$ 439,191,520
FFCB	4,352,517				4,352,517
Mortgage and asset-backed securities:					
FNMA	163,413,163				163,413,163
FHLMC	193,180,802				193,180,802
Other	4,683,904			564,164	5,248,068
Corporate debt	47,629,350	4,850,000			52,479,350
External investment pools - Fixed-income securities	2,261,006,501				2,261,006,501
Nonparticipating investment contracts	447,463,431				447,463,431
U.S. municipal notes	45,100,000				45,100,000
Commonwealth agency bonds	3,770,000		195,505,000		199,275,000
Total	$3,609,791,188	$ 4,850,000	$ 195,505,000	$ 564,164	$ 3,810,710,352

The credit quality ratings of nonparticipating investment contracts are based on the credit quality ratings at June 30, 2008 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, 2008, 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	$1,150,257,124
Securities sold under agreements to repurchase	687,200,000
Certificates of indebtedness	11,800,000

5. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans at June 30, 2008 consist of the outstanding balance of credit facilities granted to the following (in thousands):

		Enterprise funds				
	Governmenta Activities	GDB Operating Fund	Tourism Development Fund	Housing Finance Authority	Public Finance Corporation	Total
Public corporations and agencies	$ -	$3,892,943	$ -	$ -	$104,528	$3,997,471
Municipalities		1,003,259				1,003,259
Allowance for loan losses		(11,860)				(11,860)
Total loans to public sector	-	4,884,342	-	-	104,528	4,988,870
Private sector	3,133	474	271,525	230,198		505,330
Allowance for loan losses	(613)	(264)	(5,423)	(24,481)	-	(30,781)
Total loans to private sector	2,520	210	266,102	205,717	-	474,549
Balance — end of year	$2,520	$4,884,552	$266,102	$205,717	$104,528	$5,463,419

Reconciliation to the government-wide statement of net assets:	
Unrestricted loans receivable — net	$5,454,425
Restricted loans receivable — net:	
Governmental activities	2,520
Business-type activities	6,474
Total	$5,463,419

Public sector loans amounting to approximately $635 million as of June 30, 2008 were delinquent by 90 days or more, including approximately $96 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 $5.4 million in 2008. Interest collected on these loans during the year ended June 30, 2008 amounted to approximately $799 thousand.

At June 30, 2008, the Bank has established an allowance for loan losses of $11,860,000 related to a loan granted to a municipality. This loan was granted in 1991 and was being repaid until 2001, when legal action was brought against the Bank and another public entity of the Commonwealth. In 2005, a favorable judgment for the Bank was issued and the loan was required to be refinanced but, the borrower has not been able to meet its obligations. The Bank continues its efforts to collect in full this loan, however, due to the uncertainties at June 30 2008, management decided to provide an allowance for the outstanding balance of the loan. The Bank's management believes that other loans to municipalities do not posses characteristics similar to this loan and, accordingly, believes that no additional allowance is required for the remaining outstanding balance of loans to municipalities.

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 low and moderate-income multifamily housing units in Puerto Rico, and direct loans to tourism projects. These credit facilities amounted to approximately $505 million at June 30, 2008 of which approximately $206 million are mortgage loans for low and moderate-income housing units and approximately $266 million are for tourism projects.

At June 30, 2008, public sector loans amounting to approximately $3,997,471,000 were repayable from the following sources (in thousands):

Repayment source	Amount
FIA Fund	$ 1,084,454
Proceeds from future issuance of Commonwealth's general obligation bonds	1,219,714
Other — including future legislative appropriations and proceeds from future bond issuances from public entities other than the Commonwealth	1,693,303
Total	$ 3,997,471

Private sector loans classified as non-accrual amounted to approximately $41.8 million at June 30, 2008. Interest income that would have been recorded if these loans had been performing in accordance with their original terms was approximately $2.3 million in 2008. No interest was collected on these loans for the year ended June 30, 2008.

The following is a summary of private sector loans of the enterprise funds considered to be impaired as of June 30, 2008, and the related interest income for the year then ended (in thousands):

	Enterprise funds		
	GDB Operating Fund	Housing Finance Authority	Total
Recorded investment in impaired loans:			
Not requiring an allowance for loan losses	$ 210	$ -	$ 210
Requiring an allowance for loan losses	264	59,049	59,313
Total recorded investment in impaired loans	$ 474	$ 59,049	$ 59,523
Related allowance for loan losses	$ 264	$ 8,561	$ 8,825
Average recorded investment in impaired loans	474	58,555	59,029
Interest income recognized on impaired loans	-	664	664

The following is a summary of the activity in the allowance for loan losses for the year ended June 30, 2008 (in thousands):

		Enterprise Funds			
	Governmental Activities	GDB Operating Fund	Tourism Development Fund	Housing Finance Authority	Total
Balance — beginning of year	$ 874	$ 12,124	$ 5,099	$24,602	$42,699
Provision (credit) for loan losses	(247)		324	1,770	1,847
Charge-offs	(14)	-	-	(1,891)	(1,905)
Balance — end of year	$ 613	$ 12,124	$ 5,423	$24,481	$42,641

During the year ended June 30, 2008, the Housing Finance Authority sold approximately $5.5 million of single family mortgage loans receivable. The net proceeds from the sale of these loans amounted to approximately $5.6 million, including $24,168 of accrued interest. The net gain on the sale of these loans was approximately $25,000.

Since one of the Bank's principal functions is to provide financing to the Commonwealth and its instrumentalities, the Bank's loan portfolio includes loans to various departments and agencies of the Commonwealth, to various public corporations, and to municipalities, which represent a significant portion of the Bank's assets. Loans to the Commonwealth and its agencies typically include working capital lines of credit payable from short-term tax and revenue anticipation notes issued by the Commonwealth, interim financing of capital improvements payable from Commonwealth general obligation bonds, and in recent years loans to finance the Commonwealth's budget deficit, which loans are payable from uncollected taxes and from annual appropriations made by the legislature of Puerto Rico. Loans to the public sector, excluding municipalities, amounted to approximately $4.0 billion or 32% of the Bank's government-wide total assets at June 30,2008.

Many of the public sector loans are payable from legislative appropriations from, or future tax revenues of, the Commonwealth. Accordingly, the payment of these loans may be affected by budgetary constraints, the fiscal situation and the credit rating of the Commonwealth. Significant negative changes in these factors may have an adverse impact on the Bank's financial condition. During fiscal years 2003, 2004, 2005, 2006 and 2007 the Commonwealth's recurring expenditures exceeded its recurring revenues. These shortfalls were partially covered with loans from the Bank and other non-recurring revenues. In addition, the Commonwealth has preliminary estimated that it expenditures will exceed its revenues for fiscal year 2008. Also, the approved Commonwealth's budget for fiscal year 2009 shows an excess of expenditures over revenues of approximately $1 billion. During fiscal years 2003, 2004, 2005, 2006 and 2008, the Bank granted loans to the Commonwealth for $250 million, $233 million, $550 million, $741 million, and $190 million, respectively, to cover part of the Commonwealth's deficit. As of June 30, 2008, the outstanding principal amount of loans granted to finance the Commonwealth's budget deficit was $430 million.

In addition, due mainly to the Commonwealth's financial situation, in May 2005, Moody's Investors Service ("Moody's") and Standards & Poor's Rating Services ("S&P") each announced downgrades to the Commonwealth's credit ratings. Moody's and S&P lowered the rating on the Commonwealth's appropriation debt to "Baa3" and "BBB-," respectively. On February 24, 2006, Moody's placed the Commonwealth's rating on Watchlist with negative implications. On March 22, 2006, S&P placed the Commonwealth's rating on CreditWatch with negative implications. On May 8, 2006, Moody's further downgraded the Commonwealth's appropriation debt rating from Baa3 to Bal and kept the ratings on Watchlist. On July 20, 2006, S&P confirmed its BBB- rating on the Commonwealth appropriation debt, and removed the rating from CreditWatch with negative implications. S&P's rating outlook, however, remains negative. On July 21, 2006, Moody's confirmed its Bal rating on the Commonwealth's appropriation debt and removed the rating from Watchlist with negative implications. On November 6, 2007, Moody's changed the rating outlook of the Commonwealth from negative to stable. At June 30, 2008, the Commonwealth's credit rating was BBB- and Baa3 by S&P & Moody's, respectively.

In an effort to address the Commonwealth's structural budget imbalance, the Legislature enacted Act No. 117 of July 4, 2006 ("Act 117"), which amended the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a general sales and use tax of 5.5% (the "Sales Tax") to be imposed by the Commonwealth. The Act also eliminated the 5% general excise tax imposed on imported goods and the 3.6% general excise tax on goods manufactured in Puerto Rico, and provides certain income tax reductions to taxpayers. The Sales Tax was effective on November 15, 2006. Act 117 also imposed other measures to address the structural budget imbalance, such as fiscal reform, government reorganization plan, and special income tax rates to certain transactions occurring during the first semester of fiscal year 2007.

The Legislature enacted on May 13, 2006 Act No. 91, which created the Imperative Interest Fund (the "IIF"), as a separate fund to be administered by the Department of the Treasury of the Commonwealth and GDB. The IIF will generate revenues from collections of the first one percent of the Sales Tax. Such revenues shall be used for, among other, paying, refinancing or restructuring the extra-constitutional debt of the Commonwealth that was outstanding at June 30, 2006. Public sector loans to the Commonwealth, its agencies and instrumentalities that do not have the full faith and credit of the Commonwealth are considered extra-constitutional debt. As of June 30, 2008, approximately $1.1 billion of public sector loans are considered extra-constitutional debt subject to repayment from Sales Tax revenues collected by the IIF.

Act No. 91 was amended by Act No. 291, enacted on December 26, 2006, and by Act No. 56, enacted on July 6, 2007, to create the Puerto Rico Sales Tax Financing Corporation (the "Sales Tax Corporation") as an independent governmental instrumentality that will own and hold the IIF Fund for the purpose of financing the payment, retirement or defeasance of the extra-constitutional debt Pursuant to Act 91 ownership of the IIF, renamed as the Dedicated Sales Tax Fund (the "DSTF"), was transferred to the Sales Tax Corporation.

On July 31, 2007, the Sales Tax Corporation issued $2,668 million 2007 Series A bonds, and $1,333 million 2007 Series B bonds for the payment and retirement of a portion of the extra-constitutional debt owed to the Bank and the Public Finance Corporation, which was outstanding as of June 30, 2006. The Bank received $1.7 billion in partial payment of its public sector loans considered extra-constitutional debt.

Although the Commonwealth is using its best efforts in order to maximize revenues and reduce expenditures, there is no assurance that its future revenues will be greater than its expenditures.

Management of the Bank believes that the carrying amount of the loans to the public sector will be collected (including interest at the contracted rate), and that accordingly, no allowance for loan losses is needed at June 30, 2008.

6. DUE FROM FEDERAL GOVERNMENT

Under the New Secure Housing Program (the "Program"), the Housing Finance Authority is responsible for administering the Program, including contracting, supervising and paying the designers, inspectors and legal services needed for the Program. The Housing Finance Authority also provides all the funding for the Program through a $67 million non-revolving line of credit with the Bank. The Department of Housing is responsible for land acquisitions, auctioning projects, awarding construction contracts, qualifying participants and selling housing units to eligible participants.

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

In April 2007, FEMA discontinued reimbursing the Housing Finance Authority's allowable costs based on the Program's noncompliance with the scheduled dates for construction activities and case management. The Department of Housing requested a one-year extension up to December 31, 2008 and, although original request was denied, FEMA granted such request in late 2007.

On June 6, 2008, the Department of Housing requested an additional one-year extension up to December 31, 2009 for the completion of the construction and relocation of participants into new secure housing facilities. On July 1, 2008, FEMA denied the additional one-year extension. The Department of Housing requested through the Governor's Authorized Representative (GAR) on September 19, 2008 a reconsideration of FEMA's decision not to grant the extension. The Commonwealth, through the GAR, has been in constant communication with FEMA discussing the issues that have prevented the Commonwealth from complying with scheduled dates for construction activity and case management. However, FEMA has not made a final determination on the reconsideration of the additional extension request.

Based on previous experience, management believes it is probable that FEMA will accept the reconsideration and grant the additional one-year extension. Management of the Housing Finance Authority also believes that the Program has complied substantially with the terms of the grant and that all amounts claimed will be collected and, therefore, no allowance for uncollectible accounts has been established on the $20.9 million due from federal government at June 30, 2008.

7. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2008, was as follows:

	Beginning Balance	Additions	Reductions/ Reclassifications	Ending Balance
Capital assets not being depreciated — land	$10,970,990	$ -	$ -	$10,970,990
Capital assets being depreciated:				
Building	8,988,048			8,988,048
Leasehold improvements	2,450,008	1,544,853		3,994,861
Information systems	3,418,279	2,003,560	(2,099,696)	3,322,143
Office furniture and equipment	3,042,790	766,136	(957,004)	2,851,922
Software	3,773,033	883,038	(857,294)	3,798,777
Vehicles	257,885	-	(49,970)	207,915
Total capital assets being depreciated	21,930,043	5,197,587	(3,963,964)	23,163,666
Less accumulated depreciation and amortization for:				
Building	(1,460,557)	(224,701)		(1,685,258)
Leasehold improvements	(766,095)	(239,191)		(1,005,286)
Information systems	(2,981,543)	(630,591)	2,049,753	(1,562,381)
Office furniture and equipment	(1,919,866)	(503,683)	951,756	(1,471,793)
Software	(1,042,847)	(642,989)	855,406	(830,430)
Vehicles	(204,878)	(27,491)	49,702	(182,667)
Total accumulated depreciation and amortization	(8,375,786)	(2,268,646)	3,906,617	(6,737,815)
Total capital assets being depreciated — net	13,554,257	2,928,941	(57,347)	16,425,851
Total capital assets — net	$24,525,247	$ 2,928,941	$ (57,347)	$27,396,841

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 $206.3 million in 2008.

9. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

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

Carrying amount at June 30, 2008	$687,200,000
Maximum amount outstanding at any month-end	687,200,000
Average amount outstanding during the year	494,955,541
Weighted average interest rate for the year	4.83%
Weighted average interest rate at year-end	4.05%

The following summarizes the activity of securities sold under agreements to repurchase for the year ended June 30, 2008:

	Beginning Balance	Issuances	Maturities	Ending Balance
GDB Operating Fund	$ 455,000,000	$ 587,204,000	$ 355,004,000	$ 687,200,000

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, 2008, $207.2 million of securities sold under agreements to repurchase mature within one year and approximately $480 million mature during fiscal year 2011.

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. Commercial paper represents unsecured obligations of the Bank.

The following information corresponds to commercial paper:

Carrying amount at June 30, 2008	$ 500,000
Maximum amount outstanding at any month-end	670,081,000
Average amount outstanding during the year	240,390,853
Weighted average interest rate for the year	4.44%
Weighted average interest rate at year-end	2.35%

The following summarizes the commercial paper activity for fiscal year 2008:

	Beginning Balance	Issuances	Maturities	Ending Balance	Due Within One Year
GDB Operating Fund	$ 575,861,000	$ 3,928,018,900	$ 4,503,379,900	$ 500,000	$ 500,000

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. The following summarizes the certificates of indebtedness activity for the year ended June 30, 2008:

	Beginning Balance	Issuances	Maturities	Ending Balance	Due Within One Year
GDB Operating Fund	$ 11,800,000	$ -	$ -	$ 11,800,000	$ -

At June 30, 2008, certificates of indebtedness amounting to approximately $7.5 million contractually mature during the fiscal year ending 2011 and approximately $4.3 million contractually mature during the fiscal year ending June 30, 2012.

12. BONDS, NOTES AND MORTGAGE-BACKED CERTIFICATES PAYABLE, AND OTHER LIABILITIES

The activity of bonds payable and other borrowed funds for the year ended June 30, 2008 is as follows:

	Beginning Balance	Debt Issued	Debt Paid	Reductions	Ending Balance	Due Within One Year
Governmental activities:						
Commonwealth appropriation bonds and notes:						
Note payable — affordable Housing Mortgage Subsidy Program Stage 7	$10,198,536	$ -	$(5,236,531)	$ -	$4,962,005	$150,768

	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	$ -
Senior Notes Series A	885,000,000	884,000,000	(1,769,000,000)		
Senior Notes Series B	702,820,000		(108,800,000)	594,020,000	92,915,000
Senior Notes Series C	81,960,000			81,960,000	
Add (deduct) unamortized premium (discount)	16,809,316	(14,232,400)	10,272,517	12,849,433	289,456
Unrealized gain on fair value hedge	(16,381,656)		16,381,656		
Total GDB Operating Fund	1,937,207,660	869,767,600	(1,851,145,827)	955,829,433	93,204,456
Housing Finance Authority:					
Mortgage Trust III	1,033,973,874		(43,310,000)	990,663,874	43,270,000
Revenue bonds and mortgage-backed certificates:					
Single Family Mortgage Revenue Bonds, Portfolio IX	128,900,000		(4,450,000)	124,450,000	2,305,000
Single Family Mortgage Revenue Bonds, Portfolio X	246,000,000		(21,405,000)	224,595,000	3,395,000
Single family Mortgage Revenue Bonds, Portafolio XI		200,000,000		200,000,000	
Homeownership Mortgage Revenue Bonds 2000	60,220,000		(3,985,000)	56,235,000	820,000
Homeownership Mortgage Revenue Bonds 2001	65,910,000		(4,935,000)	60,975,000	1,340,000
Homeownership Mortgage Revenue Bonds 2003	29,990,000		(1,910,000)	28,080,000	620,000
Mortgage-Backed Certificates 2006 Series A	154,250,378		(11,616,403)	142,633,975	11,697,231
Total revenue bonds and mortgage-backed certificates	685,270,378	200,000,000	(48,301,403)	836,968,975	20,177,231
Subtotal	1,719,244,252	200,000,000	(91,611,403)	1,827,632,849	63,447,231
Notes payable to GDB and other financial institutions	7,844,436		(7,844,436)		
Plus unaccreted premium	666,605		(65,749)	600,856	
Less unaccreted discount and deferred loss on refundings	584,452,590		(35,421,508)	549,031,082	
Total Housing Finance Authority	1,143,302,703	200,000,000	(64,100,080)	1,279,202,623	63,447,231
Tourism Development Fund:					
Participation agreement payable	26,000,000			26,000,000	
Notes payable to GDB	184,971,171	39,229,669	(10,266,376)	213,934,464	873,000
Total Tourism Development Fund	210,971,171	39,229,669	(10,266,376)	239,934,464	873,000
Public Finance Corporation — Note payable to GDB	302,265,107		(198,329,030)	103,936,077	2,612,186
Total	3,593,746,641	1,108,997,269	(2,123,841,313)	2,578,902,597	160,136,873
Less intrafund eliminations	(606,439,515)	(39,229,669)	198,853,144	(446,816,040)	(3,485,186)
Total business-type activities	$ 2,987,307,126	$ 1,069,767,600	$ (1,924,988,169)	$ 2,132,086,557	$ 156,651,687

The annual debt service requirements to maturity, including principal and interest, for long-term debt, as of June 30, 2008, are as follows:

Year Ending June 30	GDB Operating Fund Business-Type Activities	
	Principal	Interest
2009	$ 92,915,000	$ 55,323,879
2010	72,450,000	51,275,025
2011	63,295,000	47,919,546
2012	62,665,000	44,773,171
2013	66,205,000	41,536,671
2014-2018	585,450,000	89,109,875
Total	$ 942,980,000	$ 329,938,167

The annual debt service requirements to maturity, including principal and interest, for long-term debt as of June 30, 2008, are as follows:

Year Ending June 30	Housing Finance Authority			
	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2009	$ 150,768	$ 266,090	$ 63,447,231	$ 43,005,625
2010		256,831	65,360,118	42,074,373
2011		256,831	64,622,692	41,093,838
2012		256,831	64,310,592	40,047,571
2013		261,554	63,481,001	39,070,987
2014-2018	391,610	1,047,755	277,478,626	180,058,479
2019-2023	558,528	864,392	230,587,505	151,627,124
2024-2028	1,641	697,886	605,866,959	120,513,498
2029-2033	3,109,459	301,352	306,353,125	62,782,030
2034-2038			67,140,000	13,690,409
2039-2043			18,985,000	957,724
Total	$ 4,212,006	$ 4,209,522	$ 1,827,632,849	$ 734,921,658

Year Ending June 30	Tourism Development Fund Business-Type Activities	
	Principal	Interest
2009	$ 26,000,000	$ 655,417

Governmental Activities

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

Description and Maturity Date	Interest Rate	Amount Outstanding
Note payable Affordable Housing Mortgage Subsidy Program Stage 7: Due each July 1 until July 1, 2031	4.10%-5.25%	$ 4,962,005

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.

The Note's outstanding balance at June 30, 2008 was $4,962,005 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, notes and mortgage-backed certificates payable of business-type activities consist of the following:

Description and Maturity Date	**Interest Rate**	**Amount Outstanding**
Adjustable Refunding Bonds:		
December 1, 2015	Variable, 9.00% at June 30, 2008	$ 267,000,000
GDB Senior Notes :		
Series B — December 1 until December 1, 2017	4.125%-5.00%	604,139,675
Series C — January 1, 2015	5.25%	84,689,758
Mortgage Trust III:		
Each July 1 and January 1 until July 1, 2011	Zero Coupon	84,128,969
Each July 1 and January 1 until January 1, 2021	Zero Coupon	243,748,495
Single Family Mortgage Revenue Bonds — Portfolio IX		
Each December 1 and June 1 until December 1, 2012	3.85-5.60%	124,450,000
Single Family Mortgage Revenue Bonds — Portfolio X		
Each December 1 and June 1 until December 1, 2037	4.15%-5.65%	224,595,000
Single Family Mortgage Revenue Bonds — Portfolio XI		
Each December 1 and June 1 until December 1, 2039	2.60%-5.45%	200,000,000
Mortgage-Backed Certificates, 2006 Series A		
June 29, 2026 through August 29, 2030	2.955%-6.56%	128,044,660
Homeownership Mortgage Revenue Bonds 2000 Series:		
Each June 1 and December 1 until December 1, 2032	4.25%-5.20%	56,235,000
Homeownership Mortgage Revenue Bonds 2001 Series:		
Each December 1 until December 1, 2012	4.05%-4.70%	7,310,000
June 1, 2013 and each December 1 and June 1 thereafter to December 1, 2033	4.45%-5.50%	53,665,000
Homeownership Mortgage Revenue Bonds 2003 Series:		
Each December 1 until December 1, 2013	2.55%-4.00%	4,045,000
June 1, 2013 and each December 1 and June 1 thereafter to December 1, 2033	4.375%-4.875%	24,035,000
Total		$ 2,106,086,557

The Housing Finance Authority has refunded/in-substance defeased certain bonds by placing internally generated moneys or the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the refunded or in-substance defeased bonds. Accordingly, the trust account assets and the related refunded/defeased bonds are not included in the Housing Finance Authority's financial statements. At June 30, 2008, the outstanding balance of refunded/in-substance defeased amounted to $51 million.

Single Family Mortgage Revenue Bonds-Portfolio XI — On June 4, 2008, the Housing Finance Authority issued $200,000,000 of Single Family Mortgage Revenue Bonds - Portfolio XI consisting of serial bonds of $33,770,000 maturing at dates ranging from December 1, 2009 to December 1, 2018 and term bonds of $166,230,000 maturing at various dates through December 1, 2039 (the "Portfolio XI Bonds"). The proceeds from these bonds were used to provide funds for the purchase and transfer to the trustee of mortgage-backed securities guaranteed by GNMA, FNMA or FHLMC (collectively, the "Mortgage Certificates-Portfolio XI"). The Mortgage Certificates- Portfolio XI are backed by pools of eligible mortgage loans made by participating lending institutions to low income persons and families to finance the purchase of qualified single-family residential housing in Puerto Rico. The Portfolio XI Bonds bear interest ranging from 2.60% to 5.45% payable monthly on the first day each month, commencing August 1, 2008.

The Portfolio XI Bonds are subject to special redemption prior to maturity in whole or in part, without premium, as follows (i) on October 15, 2009, from any moneys not used to acquire mortgage certificates and deposited to the credit of the special redemption fund from the acquisition fund, unless such date is extended by the Authority to one or more dates as to all or any portions of such unused moneys; (ii) on or after August 1, 2008, from any principal recoveries deposited on the credit of the special redemption fund; and (iii) on or after September 1, 2009, from any excess revenues deposited to the credit of the special redemption fund.

The term bonds amounting to $24,770,000, $32,090,000, $109,370,000 and maturing on December 1, 2023, December 1, 2028 and December 1, 2039, respectively, are subject to mandatory sinking fund redemption at a redemption price equal to the principal amount thereof, plus accrued interest to the date of redemption, on the dates and in the amounts equal to the applicable sinking fund requirement.

The Portfolio XI Bonds are also subject to optional redemption either in whole or in part on any principal payment date on or after June 1, 2013 at the following redemption prices:

Redemption Period (both dates inclusive)	**Redemption Price**
June 1, 2013 to May 31, 2014	102%
June 1, 2014 to May 31, 2015	101%
June 1, 2015 and thereafter	100%

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

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

The Note bears interest at a fixed rate of 7.5%, which is payable on a quarterly basis, and matures on April 9, 2009. The outstanding principal balance of the Note and the corresponding participation agreement payable amounted to $26 million as of June 30, 2008.

The activity for noncurrent accounts payable and accrued liabilities during the year ended June 30, 2008 follows:

Balance — beginning of period	$ 32,256,095
Additions	1,527,127
Reductions	(28,967,105)
Balance — end of period	$ 4,816,117

The activity for compensated absences included within accounts payable and accrued liabilities, during the year ended June 30, 2008 follows:

	Beginning Balance	Provision	Reductions	Ending Balance	Due Within One Year
Vacation	$2,983,938	$3,010,688	$3,544,707	$2,449,919	$1,746,262
Sickness	3,027,709	1,955,390	2,544,816	2,438,283	690,783
Total	$6,011,647	$4,966,078	$6,089,523	$4,888,202	$2,437,045

Compensated absences are available to be liquidated by the employees during the year.

13. RESTRICTED NET ASSETS — MORTGAGE LOAN INSURANCE FUND

The Housing Finance Authority is required by law to maintain an allowance for losses on insured mortgage loans, which is computed as a percentage of the outstanding principal balance of the insured mortgage loans. Losses incurred upon the foreclosure and subsequent gains or losses on the disposal of properties are credited/charged to the allowance for losses on mortgage loan insurance. At June 30, 2008, the Housing Finance Authority had restricted net assets for such purposes of approximately $54 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, 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, 2008, the off-balance-sheet risks consisted of the following (in thousands):

Financial instruments whose credit risk is represented by contractual amounts:	
Financial guarantees:	
Public sector	$ 131,362
Private sector	34,888
Total	$ 166,250
Standby letters of credit:	
Public sector	$ 450,413
Private sector	125,040
Total	$ 575,453
Commitments to extend credit — Public sector	$ 1,888,169

Following is the activity of the allowance for losses on guarantees and letters of credit for the year ended June 30, 2008:

	Beginning Balance	Provision (Credit)	Payments	Ending Balance	Due Within One Year
GDB Operating Fund	$ 1,000,000	$ -	$ -	$ 1,000,000	$ -
Tourism Development Fund	1,462,924	(192,872)		1,270,052	
Puerto Rico Development Fund	30,419	1,242,721	(429,797)	843,343	843,343
Total	$ 2,493,343	$ 1,049,849	$ (429,797)	$ 3,113,395	$843,343

15. 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. 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 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, 2008 amounted to approximately $1,090,000 and $673,000, respectively. The Bank's contributions during the years ended June 30, 2008, 2007, and 2006 amounted to approximately $1,982,000, $1,787,000, and $2,242,000, 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.

During the fiscal year 2007, the Bank's board of directors authorized an early retirement program for certain Bank's employees, subject to the approval of the Legislature and the Governor of the Commonwealth. On December 12, 2007, a bill approved by the Legislature was signed into law by the Governor of the Commonwealth.

The incremental costs of the early retirement program amounted to $40.2 million, which have been presented as a special item in the accompanying statements of activities and of revenues, expenses, and changes in fund balances. These costs consisted principally of the incremental actuarial costs of retiring earlier than at the normal retirement age, a lump-sum payment of 50% of the annual salary of the retiring employees, and the estimated liability to cover costs of life and cancer insurance until death and of medical insurance for such employees until reaching the age of 64.

16. COMMITMENTS AND CONTINGENCIES

Lease Commitments — The Bank leases office and storage space from the governmental and private sector. Principally, office space is leased under a short-term operating lease agreement that renews automatically every year, if it is not canceled by any of the parties before the beginning of each year. The storage space agreement expires in 2011.

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

Rent charged to operations in fiscal year 2008 amounted to approximately $2.1 million. At June 30, 2008, the minimum annual future rentals under noncancelable leases are approximately as follows:

Year Ending June 30	Amount
2009	$ 2,249,000
2010	2,263,000
2011	2,278,000
2012	1,850,000
2013	1,850,000
Thereafter	45,625,000
Total	$ 56,115,000

Cooperative Development Investment Fund — On August 18, 2002, the Legislature 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, 2008, the Bank has contributed $14.7 million to the Cooperative Development Investment Fund, $1.7 million of which were contributed during the year ended June 30, 2008.

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.

Loan Guarantees — The Development Fund has entered into an agreement (the "Agreement") with Economic Development Bank for Puerto Rico (EDB) whereby the Development Fund would guarantee a portion of loans granted by EDB under a government program named The Key for Your Business (the "Program"). Under the Agreement, the Development Fund would assign $10 million of its capital for the program. The Development Fund guarantees one-third of the outstanding principal balance of each loan plus accrued interest and certain other charges. The Development Fund charges one percent of the loan amount as guarantee fee and no loan can exceed $50,000. At June 30, 2008, outstanding guarantees amounted to approximately $9,997,000, and the allowance for losses on guarantees amounted to approximately $843,000. On August 28, 2008, the Development Fund and EDB amended the Agreement to increase from $10 million to $15 million the Development Fund's capital designated for the program.

Custodial Activities of Enterprise Funds — At June 30, 2008, the Housing Finance Authority was custodian of approximately $177,000 in restricted funds of CRUV. As of June 30, 2008, 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 accompanying basic financial statements.

Loan Sales and Securitization Activities — On July 13, 1992, the Housing Bank 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 become delinquent for 120 days or more. As of June 30, 2008, the aggregate outstanding principal balance of the loans pooled into the FNMA certificate amounted to approximately $702,000.

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, 2008, the principal balance of the mortgage loans serviced for others is approximately as follows:

Popular Mortgage, Inc.	$ 13,821,000
R-G Mortgage, Inc.	7,912,000
CRUV or its successor without guaranteed mortgage loan payments	54,000
Total	$21,787,000

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

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

The Public Finance Corporation has issued approximately \$5.9 billion of Commonwealth appropriation bonds (the "Bonds") maturing at various dates through 2032. 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 "Promissory 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, 2008 amounted to approximately \$1.7 billion.

The Bonds are limited obligations of the Public Finance Corporation and, except to the extent payable from bond proceeds and investment earnings thereon, will be payable solely from a pledge and assignment of amounts due under the Promissory Notes. Principal and interest on the Promissory Notes are payable solely from legislative appropriations to be made pursuant to acts approved by the Legislature of the Commonwealth. These acts provide that the Commonwealth shall honor the payment of principal and interest on the Promissory Notes, and that the Director of the OMB shall include in the budget of the Commonwealth submitted to the Legislature the amounts necessary to pay the principal and interest on the 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.

On May 13, 2006, the Legislature enacted Act No. 91, which created the FIA Fund, as a separate fund to be administered by the Department of the Treasury of the Commonwealth and the Bank. The Fund will generate funds from collections of the first one percent of the sales and consumption tax approved by the Legislature. Such funds shall be used for, among other, paying, refinancing or restructuring the extra-constitutional debt of the Commonwealth that was outstanding at June 30, 2006. The Bonds are considered extra-constitutional debt, and, accordingly, will be paid from collections received by the FIA Fund. Should the amounts generated by Act. No. 91 are not sufficient to cover debt service of the extra-constitutional debt, such shortfall is still subject to legislative appropriations.

Act No. 91 was amended by Act No. 291, enacted on December 26, 2006, and by Act No. 56, enacted on approved July 6, 2007, to create the Sales Tax Corporation as an independent instrumentality of the Commonwealth. The Sales Tax Corporation was created for the purpose of financing the payment, retirement or defeasance of the extra-constitutional of the Commonwealth, outstanding as of June 30, 2006, which are payable to the Bank and the Public Finance Corporation.

Act 91, as amended, provides that the Sales Tax Corporation will hold and own the FIA Fund, and that each fiscal-year the first one percent of the Commonwealth's share of the sales and consumption tax, will be deposited in the FIA Fund, and used to repay the Commonwealth's extra constitutional debt as of June 30, 2006.

On July 31, 2007, pursuant to Act 91, the Sales Tax Corporation issued the 2007 Series A bonds for \$2,668 million and the 2007 Series B bonds for \$1,333 million whose net proceeds were used for the payment and retirement of a portion of the extra-constitutional debt owed to the Bank and to the Public Finance Corporation. Therefore, the outstanding balance of the Bonds was reduced by approximately \$1.3 billion.

Also the Sales Tax Corporation issued on December 20, 2007, the 2007 Series C bonds for approximately $500 million, and on June 26, 2008, the 2008 Series A bonds for $737 million whose net proceeds were used for to the payment and retirement of certain of the Bonds. As a result, the no-commitment debt of the Public Finance Corporation was further reduced by approximately $1.1 billion.

Certain bonds of the Housing Finance Authority are considered no-commitment debt as more fully described in Note 2. At June 30, 2008, 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	$ 11,981,234
Restricted liabilities (no-commitment debt)	10,612,300
Restricted fund balance	$ 1,368,934
Excess of fund expenses over revenues	$ 129,264

In December 2003, the Housing Finance Authority issued $663 million in Capital Fund Program Bonds Series 2003 to lend the proceeds thereof to the Public Housing Administration (PHA), a governmental instrumentality of the Commonwealth. PHA utilized such funds for improvements to various public housing projects in the Commonwealth. The Capital Fund Program Bonds Series 2003 are limited obligations of the Housing Finance Authority, which will be paid solely from an annual allocation of public housing capital funds when received from the U.S. Department of Housing and Urban Development and other funds available under the bonds indenture. Accordingly, these bonds are considered no-commitment debt and are not presented in the accompanying basic financial statements. The outstanding balance of these bonds amounted to $597 million at June 30, 2008.

In addition, the Housing Finance Authority, as a public agency is authorized to administer the U.S. Housing Act Section 8 Programs in Puerto Rico. The revenues and expenses of such federal financial assistance are accounted for as a major governmental fund under HUD Programs. Revenues and expenditures related to the administration of the U.S. Housing Act Section 8 Programs amounted to $115,587,371 for the year ended June 30, 2008. This amount includes approximately $4,994,000 of administrative fees for services performed as contract administrator, which are reimbursed by the U.S. Department of Housing and Urban Development.

18. 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, 2008, 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 cash and due from banks, federal funds sold, repurchase and resale agreements, deposits placed with banks, 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 quoted market prices or quotations received from independent brokers/dealers.

- Financial instruments that are not generally traded, such as long-term deposits placed with banks, certificates of deposit, certificates of indebtedness, and investment contracts, and bonds and notes 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 and other borrowings 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, financial guarantees and standby letters of 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 of 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 financial guarantees relating to instrumentalities of the Commonwealth is omitted, as these arrangements are with component units of the Commonwealth.

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at June 30, 2008:

	Reported Amount	Fair Value
	(In millions)	
Financial assets:		
Cash and due from banks	$ 87	$ 87
Federal funds sold	317	317
Deposits placed with banks	1,616	1,616
Due from federal government	21	21
Investments and investment contracts	4,406	4,350
Loans receivable to public sector	4,989	4,983
Accrued interest receivable and other receivables	266	266
Financial liabilities:		
Demand deposits	2,720	2,720
Certificates of deposit	4,283	4,290
Certificates of indebtedness	12	12
Securities sold under agreements to repurchase	687	706
Commercial paper	1	1
Accounts payable and accrued liabilities	85	85
Accrued interest payable	28	28
Bonds, notes, and participation agreement payable	2,137	2,157

19. INTERFUND BALANCES AND TRANSFERS

The following table is a summary of the interfund balances as of June 30, 2008 between governmental funds and enterprise funds:

Receivable by	Payable by	Purpose	Amount
Governmental fund:	**Enterprise fund:**		
New Secure Housing Program	GDB Operating Fund	Demand deposits and accrued interest	$ 398,884
HUD Programs	GDB Operating Fund	Demand deposits and accrued interest	656,852
Other nonmajor funds (AHMSP Law 124)	GDB Operating Fund	Investment agreements and accrued interest	573,203
Other nonmajor funds (AHMSP Law 124)	GDB Operating Fund	Certificates of deposit and accrued interest	2,510,136
Other nonmajor funds (AHMSP Law 124)	GDB Operating Fund	Demand deposits and accrued interest	214,584
AHMSP-Stage 8	GDB Operating Fund	Demand deposits and accrued interest	45
AHMSP-Stage 8	GDB Operating Fund	Investment agreements and accrued interest	13,489,552
Other nonmajor funds (Special Obligation Refunding Bonds)	GDB Operating Fund	Certificates of deposit and accrued interest	5,298,550
Other nonmajor funds (Special Obligation Refunding Bonds)	GDB Operating Fund	Demand deposits and accrued interest	438,067
The Key for your Home Program	GDB Operating Fund	Demand deposits and accrued interest	1,186,830
Subtotal and balance carried forward			24,766,703

Receivable by	Payable by	Purpose	Amount
Balance brought forward			$ 24,766,703
Governmental fund:	**Enterprise fund:**		
New Secure Housing Program	Housing Finance Authority	Reimbursement of expenditures	449,936
Other Nonmajor Funds (Special Obligation Refunding Bonds)	Housing Finance Authority	Reimbursement of loan originations	1,513,524
The Key for Your Home Program	Housing Finance Authority	Advances	30,000
AHMSP-Stage 7	Housing Finance Authority	Reimbursement of expenditures	2
Subtotal			1,993,462
Total			26,760,165
Enterprise fund:	**Governmental fund:**		
GDB Operating Fund	New Secure Housing Program	Loans payable and accrued interest	(44,189,766)
GDB Operating Fund	AHMSP-Stage 7	Securities purchased under agreements to resell and accrued interest	(52,659,824)
GDB Operating Fund	AHMSP-Stage 9	Loans payable and accrued interest	(354,186)
GDB Operating Fund	Other nonmajor funds (AHMSP Stage 10)	Loans payable and accrued interest	(14,897,601)
Housing Finance Authority	AHMSP- Stage 7	Reimbursement of expenditures	(5,263,768)
Housing Finance Authority	Other nonmajor funds (AHMSP Law 124)	Reimbursement of expenditures	(569,366)
Housing Finance Authority	The Key for your Home	Reimbursement of expenditures	(117,190)
Housing Finance Authority	HUD Programs	Reimbursement of loan origination	(736,688)
Total			(118,788,389)
Total internal balances — net			$ (92,028,224)

Receivable by Fund	Payable by Fund	Purpose	Amount
Governmental fund:	**Governmental fund:**		
Other nonmajor funds (Special Obligation Refunding Bonds)	AHMSP - Stage 7	Advances	$ 11,581,631
Total balance among governmental funds eliminated			$ 11,581,631
Enterprise funds:	**Enterprise funds:**		
Housing Finance Authority	GDB Operating Fund	Demand deposits and accrued interest	$ 4,506,596
Development Fund	GDB Operating Fund	Demand deposits and accrued interest	40,293,387
Tourism Development Fund	GDB Operating Fund	Demand deposits and accrued interest	11,380,530
Public Finance Corporation	GDB Operating Fund	Demand deposits and accrued interest	1,260,680
Other Nonmajor (Education Assistance Corporation)	GDB Operating Fund	Demand deposits and accrued interest	2,364,960
Other Nonmajor (JMB Institute)	GDB Operating Fund	Demand deposits and accrued interest	42,593
Housing Finance Authority	GDB Operating Fund	Certificates of deposit and accrued interest	393,454,423
Tourism Development Fund	GDB Operating Fund	Certificates of deposit and accrued interest	45,257,688
Housing Finance Authority	GDB Operating Fund	Guaranteed investment contracts and accrued interest	188,931,031
GDB Operating Fund	Housing Finance Authority	Bonds payable	128,945,499
GDB Operating Fund	Tourism Development Fund	Loans receivable and accrued interest	214,622,764
GDB Operating Fund	Public Finance Corporation	Loans receivable and accrued interest	111,097,074
Total balance among enterprise funds eliminated			$1,142,157,225

The following table is a summary of interfund transfers for the year ended June 30, 2008:

Transfer Out	Transfer In	Transfer for	Amount
Governmental Funds:	**Governmental Funds:**		
Other Nonmajor Funds (AHMSP Law 124)	The Key for your Home	Subsidy payments	$ 38,850,091
Other Nonmajor Funds (AHMSP Law 124)	Other Nonmajor Funds (AHMSP Stage 11)	Subsidy payments	37,080,001
AHMSP- Stage 8	Other Nonmajor Funds (AHMSP Law 124)	Release of excess funds	79,534
Enterprise Funds:	**Governmental Funds:**		
Housing Finance Authority	Other Nonmajor Funds (AHMSP Mortgage Backed Certificates)	Subsidy payments	1,881,529

Transfer Out	Transfer In	Transfer for	Amount
Governmental Funds:	**Enterprise Funds:**		
Other Nonmajor Funds (AHMSP Stage 10)	Housing Finance Authority	Debt services payments	$ 2,776,210
Other Nonmajor Funds (AHMSP Law 124)	Housing Finance Authority	Issuance cost, escrow deposits and subsidy payments	2,754,716
AHMSP Stage 9	Housing Finance Authority	Debt service payments	546,956
Other Nonmajor Funds (AHMSP Portfolio III)	Housing Finance Authority	Debt service payments	38,500
Enterprise Funds:	**Enterprise Funds:**		
Housing Finance Authority	Housing Finance Authority	Contribution	20,000,000
Housing Finance Authority	Housing Finance Authority	Residual net assets	1,044,872
Housing Finance Authority	Housing Finance Authority	Subsidy payments	436,194

20. SUBSEQUENT EVENTS

Adjustable Refunding Bonds — On August 1, 2008, the Bank repurchased the $267 million outstanding balance of its adjustable refunding bonds as a result of significant increases in the interest rate of these auction rate bonds. The Bank expects to reissue these bonds at a fixed rate during fiscal year 2009.

Capital Fund Modernization Program and Housing Revenue Bonds — On August 1, 2008, the Housing Finance Authority issued the Capital Fund Modernization Program Subordinate Bonds amounting to $384,475,000 and the Housing Revenue Bonds amounting to $100,000,000. The proceeds from the issuance will be mainly used to finance a loan to a limited liability company (the "LLC") and pay the costs of issuance. The $384,475,000 bonds are limited obligations of the Authority, payable primarily by a pledge and assignment of federal housing assistance payments made available by the U.S. Department of Housing and Urban Development. The $100,000,000 bonds are also limited obligations of the Housing Finance Authority, payable from amounts deposited in escrow accounts with a trustee and the proceeds of a loan to be made by the Housing Finance Authority to the LLC using moneys received as a grant from the Department of Housing of Puerto Rico. Payment of principal, of the Housing Revenue Bonds is also secured by an irrevocable standby letter of credit issued by the Bank. These bonds are considered no-commitment debt and, accordingly, will be excluded, along with the related assets held in trust, from the Housing Finance Authority's financial statements.

Bank's Exposure to American International Group — The Bank, in connection with the issuance of certain bonds issued by the Housing Finance Authority, has entered into certain nonparticipating investment contracts with counterparties that are rated, at the time of the transaction, in accordance with the Bank's investment policies (see Note 4). At June 30, 2008, the Bank had nonparticipating investment contracts outstanding with AIG Matched Funding Corp. (AIGMF) amounting to $188,931,032.

Subsequent to June 30, 2008, the credit rating of AIGMF was lowered. The Bank is currently evaluating, with its financial advisors and legal counsel, various alternatives for these nonparticipating investment contracts, including but not limited to, unwinding these nonparticipating investment contracts and defease the related bonds issued by the Housing Finance Authority.

Commonwealth's Tax Receivable Anticipation Bonds — On September 9, 2008, October 10, 2008, October 17, 2008, November 26, 2008 and December 1, 2008, the Bank purchased an aggregate principal amount of $1 billion of Tax Receivable Anticipation Bonds of the Commonwealth of Puerto Rico, Series 2008A issued in four separate tranches in the amounts of $300,000,000, $50,000,000, $50,000,000, $250,000,000, and $350,000,000, respectively. These bonds are payable from the revenue generated from the collections of certain Commonwealth's delinquent tax receivables.

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