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, 2006, and
Independent Auditors' Report

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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, 2006, 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, 2006, and the respective changes in financial position and respective cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 30 to 39 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.

/s/ Deloitte & Touche LLP
San Juan, Puerto Rico

December 7, 2006

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Management's Discussion and Analysis

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, 2006. 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, 2006 amounted to $12,747 million and $10,650 million, respectively, for net assets of $2,097 million or 16.4% of total assets.

- Net assets increased during the fiscal year by $134 million. The increase in net assets comprises $115 million from business-type activities, and $19 million from governmental activities.

(2) Overview of the Financial Statements

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

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

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

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

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

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

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

(3) Government-wide Financial Analysis

Total assets and total liabilities of the Bank at June 30, 2006 amounted to $12,747 million and $10,650 million, respectively, for net assets of $2,097 million or 16.4% of total assets. From the $2,097 million in net assets, $1,759 million or 84% are unrestricted, $210 million or 10% are restricted for use in affordable housing programs, and the remaining 6% are invested in capital assets, restricted for debt service, and for the mortgage loan insurance program. Governmental and business-type activities are discussed separately in the following subsections.

Governmental Activities

Total assets of governmental activities amounted to $213 million at June 30, 2006, before $113 million in net balances due to business-type activities. Total liabilities amounted to $75 million, for net assets of $26 million or 25.4% 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 $55.7 million and for affordable housing programs of $22.4 million, and the unrestricted deficit of $52.3 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, 2006 and 2005 is shown below (amounts in thousands):

	June 30			
	2006	2005	Amount	Percent
Assets:				
Restricted:				
Cash and due from banks, and deposits placed with banks	$ 15,491	$ 6,730	$ 8,761	130.2%
Due from federal government	18,043	20,450	(2,407)	(11.8)%
Investments and investment contracts	173,216	200,296	(27,080)	(13.5)%
Loans receivable–net	3,749	6,577	(2,828)	(43.0)%
Other assets	2,927	3,786	(859)	(22.7)%
Total assets before internal balances	213,426	237,839	(24,413)	(10.3)%
Internal balances	(112,583)	(100,434)	(12,149)	12.1%
Total assets	100,843	137,405	(36,562)	(26.6)%
Liabilities:				
Accounts payable and accrued liabilities	23,241	42,673	(19,432)	(45.5)%
Notes payable:				
Due in one year	45	96	(51)	9,600.0%
Due in more than one year	10,199	10,244	(45)	(0.4)%
Bonds payable:				
Due in one year	41,650	36,420	5,230	14.4%
Due in more than one year	-	41,650	(41,650)	(100.0)%
Total liabilities	75,135	131,083	(55,948)	(42.7)%
Net assets:				
Restricted for debt service	55,682	53,374	2,308	4.3%
Restricted for affordable housing programs	22,354	41,645	(19,291)	(46.3)%
Unrestricted deficit	(52,328)	(88,697)	36,369	(41.0)%
Total net assets	$ 25,708	$ 6,322	$ 19,386	306.6%

Investments and investment contracts amounted to $173.2 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 $15.5 million are held to provide the funds necessary for the execution of the various affordable housing programs managed by the Puerto Rico Housing Finance Authority and for debt service. Governmental activities also have a balance due from the federal government of $18 million that is related to the reimbursement of eligible expenses incurred in the New Secure Housing Program.

The most significant liabilities of governmental activities are the bonds and notes payable amounting to $41.7 million and $10.2 million at June 30, 2006, respectively. During the year, principal payments to service the bonds amounted to $36.5 million.

Condensed financial information on expenses, program and general revenues, and changes in net assets of governmental activities for the years ended June 30, 2006 and 2005 is shown below (amounts in thousands):

	Year ended June 30, 2006		
	General Government	Housing Assistance Programs	Total
Expenses	$ 1,201	$ 192,784	$ 193,985
Program revenues:			
Charges for services – financing and investment		13,355	13,355
Operating grants and contributions	-	187,815	187,815
Net (expenses) revenues	$ (1,201)	$ 8,386	7,185
Transfers-net			12,201
Change in net assets			19,386
Net assets–beginning of year			6,322
Net assets–end of year			$ 25,708

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

Total expenses of governmental activities amounted to $194 million for the year ended June 30, 2006, a decrease of $81.7 million or 29.6% with respect to the prior year. Expenses for housing assistance programs decreased by $81 million or 30% with respect to the prior year. This decrease is driven mostly by a reduction in housing assistance program benefits under The Key for Your Home Program, which decreased by $78 million.

Revenues from financing and investing activities provided $13.4 million in 2006 and $15.5 million in 2005 to be used for the benefit of the housing assistance programs. The decrease in revenues from financing and investing activities is due to a decrease in the average balance of investments during fiscal year 2006. Grants received for housing assistance programs amounted to $187.8 million in 2006 compared to $265.2 million in 2005. The decrease in grants of the Authority's governmental activities resulted mainly from a decrease in appropriations from the Commonwealth for the repayment of bonds and housing assistance programs. These revenues decreased $76 million, from $120 million in 2005 to $44 million in 2006.

Transfers for the year include $12.2 million in net transfers from business-type activities, primarily related to transfers made by certain of the enterprise funds of the Housing Finance Authority to governmental funds, which were used for subsidy payments.

Business-Type Activities

Condensed financial information on assets, liabilities, and net assets as of June 30, 2006 and 2005 is presented below (amounts in thousands):

	June 30,		Change	
	2006	2005	Amount	Percent
Assets:				
Cash and due from banks	$ 29,434	$ 68,467	$ (39,033)	(57.0)%
Federal funds and securities purchased under agreements to resell	1,935,000	1,651,000	284,000	17.2%
Deposits placed with banks	552,266	350,503	201,763	57.6%
Investments and investment contracts	2,269,504	2,115,873	153,631	7.3%
Loans receivable–net	7,276,712	5,659,239	1,617,473	28.6%
Interest and other receivables	304,361	146,955	157,406	107.1%
Due from Puerto Rico Department of Housing	-	13,050	(13,050)	(100.0)%
Capital assets	27,860	25,277	2,583	10.2%
Other assets	138,250	97,922	40,328	41.2%
Internal balances	112,583	100,435	12,148	12.1%
Total assets	12,645,970	10,228,721	2,417,249	23.6%
Liabilities:				
Deposits:				
Demand	2,046,781	1,674,501	372,280	22.2%
Certificates of deposit	3,736,497	3,198,159	538,338	16.8%
Certificates of indebtedness	54,884	261,056	(206,172)	(79.0)%
Securities sold under agreements to repurchase	515,000	439,034	75,966	17.3%
Commercial paper	985,131	1,191,202	(206,071)	(17.3)%
Accrued interest payable	54,829	23,609	31,220	132.2%
Accounts payable, accrued liabilities and other liabilities	119,845	83,866	35,979	42.9%
Bonds and notes payable:				
Due in one year	111,429	71,715	39,714	55.4%
Due in more than one year	2,950,845	1,329,738	1,621,107	121.9%
Total liabilities	10,575,241	8,272,880	2,302,361	27.8%
Net assets:				
Invested in capital assets	27,860	25,277	2,583	10.2%
Restricted for:				
Affordable housing programs	188,025	231,006	(42,981)	(18.6)%
Mortgage loan insurance	43,841	40,383	3,458	8.6%
Unrestricted	1,811,003	1,659,175	151,828	9.2%
Total net assets	$ 2,070,729	$ 1,955,841	$ 114,888	5.9%

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

Federal funds and securities purchased under agreements to resell increased by $284 million or 17.2%, from $1,651 million at June 30, 2005 to $1,935 million at June 30, 2006. Deposits placed with banks amounted to $552.3 million at June 30, 2006 compared to $350.5 million at June 30, 2005. Both increases respond primarily to the increase in deposits, and secondarily, to the new notes issued by the Bank during 2006.

Investments and Investment Contracts

Investments and investment contracts held in business-type activities amounted to $2,269.5 million at June 30, 2006. This amount represents an increase of $153.6 million or 7.3% when compared to prior year balance. This increase is mostly attributed to the remaining funds made available by the new notes issued by the Bank and by new deposits.

The investment portfolio comprised 17.9% of the total assets of the Bank's business-type activities at June 30, 2006, compared to 21% at the close of fiscal year 2005. Within the investment securities portfolio, $1,447.6 million at June 30, 2006 and $1,176 million at June 30, 2005 were restricted or pledged as collateral or payment source for specific borrowings.

Loans Receivable

Net loans receivable of $7,276.7 million accounted for 57.5% of total assets of business-type activities at June 30, 2006 (55% in 2005). The increase of $1,617.5 million in net loans was driven by an increase in public sector loans, where the largest increase was in loans to the Department of the Treasury of the Commonwealth of Puerto Rico (the "Department of the Treasury") including temporary financing to be repaid with the new sales and consumption tax to be imposed effective on November 15, 2006 by the Commonwealth.

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

Private sector loans outstanding at June 30, 2006 and 2005 amounted to $474 million and $425 million, respectively, net of allowance for loan losses of $52 million and $56 million, respectively.

Capital Assets

Capital assets, net of accumulated depreciation and amortization, amounted to $27.9 million at June 30, 2006, an increase of $2.6 million from prior year. The increase was mainly driven by the associated cost of leasehold improvements generated by the moving of the Housing Finance Authority offices.

Other Assets

Other assets amounted to $138.3 million at June 30, 2006, an increase of $40.3 million from prior year. The increase is mostly attributed to the receipt of two separate properties, included as other real estate available for sale, as consideration for the repayment of some loans. The properties have a book value of $48.2 million as of June 30, 2006.

Deposits

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

Demand deposits and certificates of deposit had a combined net increase of $910.6 million from $4,872.7 million at June 30, 2005. The primary reason for this increase is an increase in the Department of the Treasury deposits.

Certificate of Indebtedness

Certificates of indebtedness decreased by $206 million or by 79% from $261 million to $55 million at June 30, 2006, due to the expiration of a deposit amounting to $200 million from a private entity.

Securities Sold Under Agreement to Repurchase

Securities sold under agreements to repurchase increased by $76 million or by 17.3% from $439 million to $515 million at June 30, 2006. As part of its assets/liabilities management, the Bank is relying on this type of borrowings to fund certain investments.

Commercial Paper

Commercial paper decreased by 17.3% from $1,191.2 million at June 30, 2005 to $985 million at June 30, 2006. Commercial paper has been progressively substituted by long-term debt issues.

Other Borrowed Funds

Bonds and notes payable increased by 118.5% from $1,401 million at June 30, 2005 to $3,062 million at June 30, 2006. This increase is attributed to the $1.7 billion notes issued by the Bank during the current fiscal year. For additional information on the activity of bonds payable during the year, see note 12 to the basic financial statements.

Condensed financial information on expenses, program revenues, and changes in net assets for business-type activities for the years ended June 30, 2006 and 2005 is presented below (amounts in thousands):

	Year ended June 30, 2006			
		Program revenues		
		Charges for services		
Activity	Expenses	Fees, commissions, and other	Financing and investment	Net revenues (expenses)
GDB Operating Fund	$ 361,648	$ 13,378	$ 429,338	$ 81,068
Housing Finance Authority	113,138	25,465	80,794	(6,879)
Tourism Development Fund	13,971	2,931	16,641	5,601
Public Finance Corporation	55		79	24
Capital Fund	89	1	4,308	4,220
Development Fund	39	6	6,699	6,666
Other nonmajor	99		9	(90)
Total	$ 489,039	$ 41,781	$ 537,868	90,610
Special items				
Reimbursement of net guaranty disbursements from Commonwealth of Puerto Rico				21,498
Income from sponsored housing programs				18,039
Net loss on in-substance defeasance of bonds payable				(3,058)
Transfers to governmental activities				(12,201)
Change in net assets				114,888
Net assets–beginning of year				1,955,841
Net assets–end of year				$ 2,070,729

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

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 $429.3 million from its loan and investment portfolios, and $13.4 million in other charges for services. These revenues covered $361.6 million in expenses for net revenues from GDB Operating Fund of $81.1 million, surpassing the net revenues of any other activity.

The Development Fund activities were the second largest contributor to the change in net assets with net revenues of $6.7 million. Other contributors to the change in net assets were the Tourism Development Fund and the Capital Fund with net revenues of $5.6 million and $4.2 million, respectively.

(4) Analysis of Fund Financial Statements

Governmental Funds

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

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

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

Overall, the fund balance increased approximately $48 thousand during the year 2006. This fund's operations are currently limited to providing certain housing assistance payment benefits. The fund holds approximately $22 million in assets resulting from the surplus of contributions from the Commonwealth during 2005.

Affordable Housing Mortgage Subsidy Program (Stage 9)

This nonmajor separately presented fund is the Stage 9 of the AHMSP of the Authority. The fund's operating objective is to provide funds for low income families to be used for the down payment on mortgages for the acquisition of dwelling. The fund receives appropriations from the Commonwealth to fund these payments. During fiscal year 2006, this fund did not receive any intergovernmental revenue from the Commonwealth. This fund transferred in fiscal year 2006 to other governmental funds $37 million to provide subsidies and $7 million to enterprise funds to cover debt service.

Subsidy Prepayment Refunding Bonds – Debt Service

This fund is used to account for the resources available for the payment of certain bonds that were issued for the prepayment of subsidies. The fund received Commonwealth appropriations of approximately $30 million during 2006. The debt service requirements amounted to approximately $32 million during 2006. At June 30, 2006 and 2005, total bonds payable outstanding to be repaid through this debt service fund amounted to approximately $32 and $61 million, respectively.

New Secure Housing Program

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

During the fiscal years 2006 and 2005, this fund recognized revenues from the federal government and Commonwealth appropriations and contributed property of approximately $24 and $6 million, respectively. Funds are requested from the federal government as eligible expenditures are incurred.

Construction costs paid during the years ended June 30, 2006 and 2005 amounted to $35 million and $43 million, respectively, which are presented as housing subsidy payments 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 completion of certain 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 with costs directly related to the purchase and rehabilitation of housing units. Total assets increased by $10 million when compared to 2005. The fund had expenditures of $20 million, a decrease of $78 million, or 80%, from 2005. The decrease is the result of the overhaul implemented by management in the benefits award formula for the Program, which resulted in the reduction of $78 million in benefits awarded, while keeping the target number of awardees constant. The fund also received $53 million of transfers from other funds, mainly from Affordable Housing Mortgage Subsidy Program (Stage 9). Act 124, the enabling legislation pursuant to which the Affordable Housing Mortgage Subsidy Program was created, allows for the transfer of fund surplus identified in other Stages under the act to be used, among other permissible uses, to further the Key for your Home Program fund.

Enterprise Funds

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

GDB Operating Fund

Total assets of the GDB Operating Fund amounted to $11,790 million at June 30, 2006, compared to $8,724 million at June 30, 2005. The increase in the combined balance of federal funds sold, deposits placed with banks, investments and investment contracts, which increase amounted to $971 million, was driven by the increase in funds produced by new deposits and by the notes referred to below. These new funds were primarily used to fund the increase in loans which amounted to $1,859 million or 33.7%; from $5,515 in 2005 to $7,375 in 2006. Total liabilities increased by $2,985 million to $10,489 million at June 30, 2006. The most significant increase was in bonds payable that increased $1,660 million from $267 million to $1,927 million at June 30, 2006. The Bank issued $1.7 billion in notes during the current year in order to provide the Bank with more liquidity to provide loans. See Note 12 to the basic financial statements. Deposits increased 23% or $1,268 million from $5,516 million June 30, 2005 to $6,784 million at June 30, 2006. As previously discussed, the source of the deposits increase is a growth of the Department of the Treasury deposits and of deposits from the private sector.

Change in net assets of the GDB Operating Fund (excluding the $500 million contribution to the Special Communities Irrevocable Trust Fund made in December 2004) decreased 31.8% from $118.9 million in 2005 to $81.1 million in 2006. Following we discuss the various components of the change in net assets of the GDB Operating Fund, compared to the prior year.

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

Net investment income, the difference between investment income and interest expense, decreased from $149.6 million in 2005 to $106.1 million in 2006. Interest expense increased by 118.4%, or from $148 million to $323.2 million, while interest income increased by 44.3% or from $297.6 million to $429.3 million. The decrease in net interest income can be attributed to the negative change in fair value of investments of $10.1 million, and to faster repricing of interest bearing liabilities as compared to the repricing of the Bank's interest earning assets due to the increases in interest rate made by the Federal Reserve.

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

In 2006, the Bank collected $12.7 million as a reimbursement from the Commonwealth of Puerto Rico in connection with a guarantee honored on behalf of Puerto Rico Maritime Shipping Authority during prior years. The reimbursement was registered as a credit for losses on guarantees and letters of credit, thus the positive variance when compared to the previous year.

No additional provision for losses on guarantees and letters of credit was recorded in 2006 and 2005 by the GDB Operating Fund as the allowance was considered adequate.

(c) Noninterest Income

Fiscal agency fees income increased 94% from $4.2 million in 2005 to $8.1 million in 2006 due to more fiscal activity than that of the prior year.

(d) Noninterest Expenses

Salaries and fringe benefits increased only by $450 thousand or 1.8% in 2006.

The increase of 24% in other expenses is mainly due to a provision for losses on other assets of $3.3 million.

The Bank entered into new interest rate exchange (swap) agreements to hedge the changes in fair value of certain of the new notes issued during the current fiscal year. For the year ended June 30, 2006, the ineffective portion of these swaps and the change in fair value of the swaps used to manage the variability of cash flows of certain of the Bank's deposits and the variable rate bonds payable resulted in a loss of $2.7 million. See Note 15 to the basic financial statements.

(e) Nonoperating Expenses

The decrease in nonoperating expenses is due to the $500 million contribution to the Special Communities Irrevocable Trust Fund made by the Bank in 2005.

Puerto Rico Housing Finance Authority

Net assets of the Authority decreased $4.1 million, from $532 million as of June 30, 2005 to $528 million as of June 30, 2006. This decrease is the net result of a decrease of $14 million in investment income in line with the reduction of investments, a provision of losses of $15.6 million, a loss of $3.1 million in the in-substance defeasance of certain bonds payable, offset by a special item amounting to $18 million related to sponsored housing programs, a reduction of $8 million in interest expense due to the repayment of bonds and a credit of $1.2 million from mortgage loan insurance due to lower outstanding balances of loans insured.

Capital Fund

The Capital Fund's total net assets increased $4.2 million or 6% during the year to $74.5 million at June 30, 2006. This increase is mainly attributed to the net increase in fair value of investments of approximately $3.5 million and dividend and interest income received of $760,000.

Development Fund

Net assets of the Development Fund increased by $6.7 million or 19.6% during the year to $40.7 million at June 30, 2006. This increase is attributed to the collection of $3.8 million in dividends from the venture capital investments, to a $2.1 million gain realized after the sale of the Fund's investments, and to an increase in interest income due to higher interest rates during 2006 when compared to 2005.

Tourism Development Fund

Total assets increased to $422.6 million from $345.4 million in 2005. This increase is mainly attributed to the reimbursement from the Commonwealth of Puerto Rico of $21.5 million related to guarantees honored on behalf of some tourism projects; and secondly, to the increase in the loan portfolio. At June 30, 2006, outstanding guarantees and letter of credit of the Tourism Development Fund stood at $130 million. Net assets of the Tourism Development Fund increased by $27 million or 27.6% during the year to $125.5 million at June 30, 2006. The positive variance in the change in net assets is due to the $21.5 million reimbursement mentioned above.

Public Finance Corporation

Net assets increased by $24 thousand or 2.2% from fiscal year 2005. The increase is attributed mainly to interest income on deposits of approximately $79 thousand. Total assets increased $303 million or 29,370% from prior year. The increase is attributed to a loan obtained in order to provide the Corporation with liquidity to provide future advances to the Commonwealth.

(5) Debt

Total bonds and notes outstanding at year-end amounted to $3,062 million of which $1,076 million are payable from restricted assets held by the Puerto Rico Housing Finance Authority. There were $1.7 billion new bonds issued during the year on the enterprise funds. Repayments and other reductions in debt outstanding aggregated $291 million. See Note 12 to the basic financial statements for additional information on debt activities during the year.

(6) Subsequent Events

Puerto Rico Housing Finance Authority

Sale of Mortgage Loans—On August 11, 2006 and October 10, 2006, the Housing Finance Authority sold mortgage loans resulting in a gain of approximately $200,000.

Debt Issuance— On August 23, 2006, the Authority issued Mortgage-backed Certificates, 2006 Series A (the "Certificates") amounting to $165,643,717.

Public Finance Corporation

Subsequent to June 30, 2006, the Public Finance Corporation disbursed approximately $303 million to pay the fiscal year 2007 debt service of its no-commitment debt on behalf of the Commonwealth. On October 4, 2006, the Department of the Treasury of the Commonwealth and the Bank, as administrators of the IIF, entered into a memorandum of understanding whereby the IIF agrees that the payment of principal of and interest on this advance will be paid from collections received by the IIF.

See Note 21 to the basic financial statements for additional information on subsequent events.

(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.

ASSETS	Governmental Activities	Business-type Activities	Total
Cash and due from banks	$ -	$ 3,066,194	$ 3,066,194
Federal funds sold		1,935,000,000	1,935,000,000
Deposits placed with banks		541,449,283	541,449,283
Investments and investment contracts		821,944,820	821,944,820
Loans receivable—net		7,268,713,058	7,268,713,058
Accrued interest receivable		292,392,245	292,392,245
Internal balances	(112,583,059)	112,583,059	-
Restricted assets:			
Cash and due from banks	4,734,628	26,367,550	31,102,178
Deposits placed with banks	10,756,130	10,816,394	21,572,524
Due from federal government	18,043,192		18,043,192
Investments and investment contracts	173,215,548	1,447,559,379	1,620,774,927
Loans receivable—net	3,749,351	7,998,907	11,748,258
Interest and other receivables	671,904	11,969,345	12,641,249
Real estate available for sale	1,855,242	1,786,182	3,641,424
Other assets		6,629,621	6,629,621
Real estate available for sale		70,897,683	70,897,683
Capital assets		27,859,609	27,859,609
Other assets	400,156	58,936,274	59,336,430
TOTAL	100,843,092	12,645,969,603	12,746,812,695
LIABILITIES			
Commercial paper		985,131,418	985,131,418
Accrued interest payable		51,143,568	51,143,568
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:			
Demand		2,046,780,528	2,046,780,528
Certificates of deposit:			
Due in one year		3,585,872,507	3,585,872,507
Due in more than one year		150,624,824	150,624,824
Certificates of indebtedness:			
Due in one year		47,384,000	47,384,000
Due in more than one year		7,500,000	7,500,000
Accounts payable and accrued liabilities:			
Due in one year	22,427,862	47,629,417	70,057,279
Due in more than one year		42,901,465	42,901,465
Notes payable:			
Due in one year	45,047	58,967,850	59,012,897
Due in more than one year	10,198,536	1,660,090,586	1,670,289,122
Other liabilities due in more than one year:			
Participation agreement payable		26,000,000	26,000,000
Securities sold under agreements to repurchase		515,000,000	515,000,000
Bonds payable		267,000,000	267,000,000
Allowance for losses on guarantees and letters of credit		2,524,246	2,524,246
Liabilities payable from restricted assets:			
Accrued interest payable	813,689	3,685,581	4,499,270
Accounts payable and accrued liabilities:			
Due in one year		740,666	740,666
Due in more than one year		49,117	49,117
Bonds payable:			
Due in one year	41,650,000	52,461,000	94,111,000
Due in more than one year	-	1,023,753,916	1,023,753,916
Total liabilities	75,135,134	10,575,240,689	10,650,375,823
NET ASSETS			
Invested in capital assets		27,859,609	27,859,609
Restricted for:			
Debt service	55,682,108		55,682,108
Mortgage loan insurance		43,841,290	43,841,290
Affordable housing programs	22,353,715	188,024,516	210,378,231
Unrestricted net assets (deficit)	(52,327,865)	1,811,003,499	1,758,675,634
Total net assets	$ 25,707,958	$ 2,070,728,914	$ 2,096,436,872

See accompanying notes to basic financial statements.

		Program Revenues			Net Revenues (Expenses) and Changes in Net Assets		
	Expenses	Charges for Services - Fees, Commissions, and Others	Charges for Services - Financing and Investment	Operating Grants and Contributions	Governmental Activities	Business-type Activities	Total
Functions/programs:							
Governmental activities:							
General government and other	$ 1,200,660	$ -	$ -	$ -	$ (1,200,660)	$ -	$ (1,200,660)
Housing assistance programs	192,784,380	-	13,355,495	187,814,649	8,385,764	-	8,385,764
Total governmental activities	193,985,040	-	13,355,495	187,814,649	7,185,104	-	7,185,104
Business-type activities:							
GDB Operating Fund	361,648,507	13,377,867	429,338,074			81,067,434	81,067,434
Housing Finance Authority	113,137,608	25,464,594	80,794,447			(6,878,567)	(6,878,567)
Capital Fund	88,645	604	4,308,136			4,220,095	4,220,095
Development Fund	39,281	6,620	6,698,873			6,666,212	6,666,212
Tourism Development Fund	13,971,021	2,930,973	16,641,193			5,601,145	5,601,145
Public Finance Corporation	55,508		78,823			23,315	23,315
Other nonmajor	98,620	-	8,508	-	-	(90,112)	(90,112)
Total business-type activities	489,039,190	41,780,658	537,868,054	-	-	90,609,522	90,609,522
Total	$ 683,024,230	$ 41,780,658	$ 551,223,549	$ 187,814,649	7,185,104	90,609,522	97,794,626
Transfers-net					12,200,383	(12,200,383)	-
Special items:							
Reimbursement of net guaranty disbursements from Commonwealth of Puerto Rico						21,497,903	21,497,903
Income from sponsored housing programs						18,039,373	18,039,373
Net loss on in-substance defeasance of bonds payable					-	(3,058,086)	(3,058,086)
Change in net assets					19,385,487	114,888,329	134,273,816
Net assets–beginning of year					6,322,471	1,955,840,585	1,962,163,056
Net assets–end of year					$ 25,707,958	$ 2,070,728,914	$ 2,096,436,872

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, 2006

	Affordable Housing Mortgage Subsidy Program-Stage 8	Affordable Housing Mortgage Subsidy Program – Stage 9	Subsidy Prepayment Refunding Bonds – Debt Service	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	$ -	$ -	$ -	$ 2,663,329	$ 20,083	$ -	$ 11,610,597	$ (8,951,808)	$ 5,342,201
Restricted:									
Cash and due from banks		629	3,000			3,637,420	1,093,579		4,734,628
Deposits placed with banks					2,725,000		8,031,130		10,756,130
Due from federal government				18,043,192					18,043,192
Investments and investment contracts	2,744,205	14,770,044	32,187,500				123,513,799		173,215,548
Loans receivable-net							3,749,351		3,749,351
Due from other funds	19,491,593		478,888	9,999,926	17,994,110	136,639	6,925,383		55,026,539
Interest and other receivables	14,327	20,024	170,352	82,086			385,115		671,904
Real estate available for sale							1,855,242		1,855,242
Other assets	-	-	-	-	-	-	20,749	-	20,749
TOTAL	$ 22,250,125	$ 14,790,697	$ 32,839,740	$ 30,788,533	$ 20,739,193	$ 3,774,059	$ 157,184,945	$ (8,951,808)	$ 273,415,484
LIABILITIES									
Accounts payable and accrued liabilities	$ 130,490	$ 81,355	$ 60,129	$ 14,906,464	$ 2,525,825	$ 3,774,059	$ 949,540	$ -	$ 22,427,862
Due to other funds		69,842,835	76,686	34,445,307	880		77,537,899	(8,951,808)	172,951,799
Deferred revenue	-	-	-	13,757,895	-	-	-	-	13,757,895
Total liabilities	130,490	69,924,190	136,815	63,109,666	2,526,705	3,774,059	78,487,439	(8,951,808)	209,137,556
FUND BALANCES (DEFICIT)									
Reserved for:									
Long-term loans receivable and other assets							5,623,925		5,623,925
Debt service			32,702,925				22,979,183		55,682,108
Unreserved—special revenue funds	22,119,635	(55,133,493)	-	(32,321,133)	18,212,488	-	50,094,398	-	2,971,895
Total fund balances (deficit)	22,119,635	(55,133,493)	32,702,925	(32,321,133)	18,212,488	-	78,697,506	-	64,277,928
TOTAL	$ 22,250,125	$ 14,790,697	$ 32,839,740	$ 30,788,533	$ 20,739,193	$ 3,774,059	$ 157,184,945	$ (8,951,808)	$ 273,415,484

Amounts reported for governmental activities in the statement of net assets are different because:	
Total fund balance	$ 64,277,928
Deferred bond issue costs that are recorded as expenditures in governmental funds, but are capitalized in the government-wide financial statements	379,407
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	(51,893,583)
Accrued interest payable not due and payable in the current period	(813,689)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds	13,757,895
Net assets of governmental activities	$ 25,707,958

See accompanying notes to basic financial statements.

Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds

FOR THE YEAR ENDED JUNE 30, 2006

	Affordable Housing Mortgage Subsidy Program-Stage 8	Affordable Housing Mortgage Subsidy Program – Stage 9	Subsidy Prepayment Refunding Bonds – Debt Service	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 contributed property for housing assistance programs	$ -	$ -	$ 29,719,519	$ 5,728,525	$ -	$ -	$ 8,369,551	$ 43,817,595
Intergovernmental—federal government				23,839,658		114,432,019		138,271,677
Interest on investments	1,184,664	1,898,601	2,060,403	3,815	501,095		7,464,992	13,113,570
Interest income on loans—net							537,955	537,955
Net decrease in fair value of investments	(136,370)						(159,660)	(296,030)
Other	-	-	922	3,136,400	-	-	1,023,193	4,160,515
Total revenues	1,048,294	1,898,601	31,780,844	32,708,398	501,095	114,432,019	17,236,031	199,605,282
EXPENDITURES								
Current:								
General government and other	32,925	83,060	6,000				1,078,675	1,200,660
Housing assistance programs	967,426	1,537,668		35,432,197	20,157,539	114,432,019	6,899,808	179,426,657
Provision for loan losses							1,159,167	1,159,167
Debt service:								
Principal			28,595,000				7,920,748	36,515,748
Interest	-	3,593,872	3,162,746	1,338,454	-	-	3,956,282	12,051,354
Total expenditures	1,000,351	5,214,600	31,763,746	36,770,651	20,157,539	114,432,019	21,014,680	230,353,586
Excess (deficiency) of revenues over (under) expenditures	47,943	(3,315,999)	17,098	(4,062,253)	(19,656,444)	-	(3,778,649)	(30,748,304)
Other financing sources (uses):								
Transfers in	-	37,000			52,679,251		14,589,805	67,306,056
Transfers out	-	(44,051,271)	-	-	(43,500)	-	(11,010,902)	(55,105,673)
Total other financing sources (uses)	-	(44,014,271)	-	-	52,635,751	-	3,578,903	12,200,383
Net change in fund balance	47,943	(47,330,270)	17,098	(4,062,253)	32,979,307	-	(199,746)	(18,547,921)
Fund balance (deficit)–beginning of year	22,071,692	(7,803,223)	32,685,827	(28,258,880)	(14,766,819)	-	78,897,252	82,825,849
Fund balance (deficit)–end of year	$ 22,119,635	$ (55,133,493)	$ 32,702,925	$ (32,321,133)	$ 18,212,488	$ -	$ 78,697,506	$ 64,277,928

See accompanying notes to basic financial statements.

Amounts reported for governmental activities in the statement of activities are different because:		
Net change in fund balances - total governmental funds	$	(18,547,921)
Repayment of the principal of long-term debt consumes the current financial resources of governmental funds.		36,515,748
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.		(130,702)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds		1,564,862
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	$	19,385,487

See accompanying notes to basic financial statements

Balance Sheet - Enterprise Funds

AS OF JUNE 30, 2006

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
ASSETS									
Current assets:									
Cash and due from banks	$ 2,372,859	$ 5,140,058	$ -	$ 40,639,974	$ 5,782,975	$ 1,062,469	$ 2,394,623	$ (54,326,764)	$ 3,066,194
Federal funds sold	1,935,000,000								1,935,000,000
Deposits placed with banks	503,557,870	113,231,653			60,610,766	303,023,792		(438,974,798)	541,449,283
Investments and investment contracts	384,857,930		367,226		29,699,326				414,924,482
Loans receivable–net	1,147,182,214	6,438,271			47,307,752			(15,173,063)	1,185,755,174
Accrued interest receivable	303,064,910	1,346,446	1,439	84,022	2,190,325	46,026	8,565	(14,349,488)	292,392,245
Other current receivables	26,409,979	10,325,367					831		36,736,177
Other current assets	725,202	32,428							757,630
Due from governmental funds	171,366,787	1,585,012							172,951,799
Restricted:									
Cash and due from banks		27,219,190						(851,640)	26,367,550
Deposits placed with banks		286,279,584						(275,468,841)	10,810,743
Investments and investment contracts	73,310,294	5,079,484							78,389,778
Accrued interest and other receivables		12,064,758						(95,413)	11,969,345
Real estate available for sale	-	1,786,182	-	-	-	-	-	-	1,786,182
Total current assets	4,547,848,045	470,528,433	368,665	40,723,996	145,591,144	304,132,287	2,404,019	(799,240,007)	4,712,356,582
Noncurrent assets:									
Restricted:									
Deposits placed with banks		5,651							5,651
Investments and investment contracts	521,063,232	1,075,705,749						(227,599,380)	1,369,169,601
Loans receivable–net		7,998,907							7,998,907
Other assets		6,629,621							6,629,621
Investments and investment contracts	382,188,993	17,677,529	74,157,933		43,208,922			(110,213,039)	407,020,338
Loans receivable–net	6,227,619,428	174,059,523			233,766,364			(552,487,431)	6,082,957,884
Real estate available for sale	70,023,932	873,751							70,897,683
Capital assets	25,072,140	2,785,106					2,363		27,859,609
Other assets	16,456,552	4,985,915	-	-	-	-	-	-	21,442,467
Total noncurrent assets	7,242,424,277	1,290,721,752	74,157,933	-	276,975,286	-	2,363	(890,299,850)	7,993,981,761
Total assets	$ 11,790,272,322	$ 1,761,250,185	$ 74,526,598	$ 40,723,996	$ 422,566,430	$ 304,132,287	$ 2,406,382	$ (1,689,539,857)	$ 12,706,338,343

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, 2006

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
LIABILITIES									
Current liabilities:									
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:									
Demand	$ 2,105,656,182	$ -	$ -	$ -	$ -	$ -	$ -	$ (58,875,654)	$ 2,046,780,528
Certificates of deposit	4,300,316,146							(714,443,639)	3,585,872,507
Certificates of indebtedness	47,384,000								47,384,000
Commercial paper	985,131,418								985,131,418
Accrued interest payable	60,340,634	616,755			4,578,472	52,608		(14,444,901)	51,143,568
Accounts payable and accrued liabilities	24,427,784	14,318,180	19,880	3,601	5,141,343	2,404	18,975	3,697,250	47,629,417
Due to governmental funds	55,026,538	5,342,202							60,368,740
Notes payable	41,427,559	22,307,561	-	-	305,000	10,100,793	-	(15,173,063)	58,967,850
Total current liabilities payable from unrestricted assets	7,619,710,261	42,584,698	19,880	3,601	10,024,815	10,155,805	18,975	(799,240,007)	6,883,278,028
Current liabilities payable from restricted assets:									
Accrued interest payable		3,685,581							3,685,581
Accounts payable and accrued liabilities		740,666							740,666
Bonds payable	-	52,461,000	-	-	-	-	-	-	52,461,000
Total current liabilities	7,619,710,261	99,471,945	19,880	3,601	10,024,815	10,155,805	18,975	(799,240,007)	6,940,165,275
Noncurrent liabilities:									
Certificates of deposits, principally from the Commonwealth of Puerto Rico and its public entities	378,224,204							(227,599,380)	150,624,824
Certificates of indebtedness	7,500,000								7,500,000
Securities sold under agreements to repurchase	515,000,000								515,000,000
Allowance for losses on guarantees and letters of credit	1,000,000				1,524,246				2,524,246
Accounts payable and accrued liabilities	40,718,618						2,182,847		42,901,465
Participation agreement payable					26,000,000				26,000,000
Bonds and notes payable	1,927,090,586				259,564,431	292,922,999		(552,487,430)	1,927,090,586
Noncurrent liabilities payable from restricted assets:									
Allowance for losses on mortgage loan insurance		49,117							49,117
Bonds payable	-	1,133,966,956	-	-	-	-	-	(110,213,040)	1,023,753,916
Total noncurrent liabilities	2,869,533,408	1,134,016,073	-	-	287,088,677	292,922,999	2,182,847	(890,299,850)	3,695,444,154
Total liabilities	10,489,243,669	1,233,488,018	19,880	3,601	297,113,492	303,078,804	2,201,822	(1,689,539,857)	10,635,609,429
NET ASSETS									
Invested in capital assets	25,072,140	2,785,106					2,363		27,859,609
Restricted for:									
Mortgage loan insurance		43,841,290							43,841,290
Affordable housing programs		188,024,516							188,024,516
Unrestricted	1,275,956,513	293,111,255	74,506,718	40,720,395	125,452,938	1,053,483	202,197	-	1,811,003,499
Total net assets	1,301,028,653	527,762,167	74,506,718	40,720,395	125,452,938	1,053,483	204,560	-	2,070,728,914
Total liabilities and net assets	$ 11,790,272,322	$ 1,761,250,185	$ 74,526,598	$ 40,723,996	$ 422,566,430	$ 304,132,287	$ 2,406,382	$ (1,689,539,857)	$ 12,706,338,343

See accompanying notes to basic financial statements.

Statement of Revenues, Expenses, and Changes in Net Assets - Enterprise Funds

FOR THE YEAR ENDED JUNE 30, 2006

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Total
OPERATING REVENUES:								
Investment income:								
Interest income on federal funds sold and securities purchased under agreements to resell	$ 40,884,264	$ 1,641,263	$ -	$ -	$ -	$ -	$ -	$ 42,525,527
Interest income on deposits placed with banks	7,886,066	24,026,589		661,327	1,765,555	78,823	8,508	34,426,868
Interest and dividend income on investment and investment contracts	57,895,893	61,327,707	759,915	3,814,064	2,698,076			126,495,655
Net increase (decrease) in fair value of investments	(1,560,517)	(16,085,637)	3,548,221	2,223,482	(814,962)	-	-	(12,689,413)
Total investment income	105,105,706	70,909,922	4,308,136	6,698,873	3,648,669	78,823	8,508	190,758,637
Interest income on loans receivable:								
Public sector	323,161,774							323,161,774
Private sector	1,070,594	9,884,525	-	-	12,992,524	-	-	23,947,643
Total interest income on loans	324,232,368	9,884,525	-	-	12,992,524	-	-	347,109,417
Total investment income and interest income on loans	429,338,074	80,794,447	4,308,136	6,698,873	16,641,193	78,823	8,508	537,868,054
Noninterest income:								
Fiscal agency fees	8,145,123	278,785						8,423,908
Commitment, guarantee and other service fees	3,620,416	9,457,474		6,620	2,078,387			15,162,897
Mortgage loan insurance premiums		2,759,875						2,759,875
Gain on sale of foreclosed real estate available for sale		4,359,584						4,359,584
Gain on sale of loans		1,922,339						1,922,339
Other income	1,612,328	6,686,537	604	-	852,586	-	-	9,152,055
Total noninterest income	13,377,867	25,464,594	604	6,620	2,930,973	-	-	41,780,658
Total operating revenues	442,715,941	106,259,041	4,308,740	6,705,493	19,572,166	78,823	8,508	579,648,712
OPERATING EXPENSES:								
Provision for loan losses	653,836	2,069,287	-	-	2,452,075	-	-	5,175,198
Interest expense:								
Deposits	228,595,905							228,595,905
Securities sold under agreements to repurchase	18,540,183	1,626,512						20,166,695
Commercial paper	40,146,063							40,146,063
Certificates of indebtedness	8,522,795							8,522,795
Bonds and notes payable	27,424,772	78,076,979	-	-	14,030,023	52,608	-	119,584,382
Total interest expense	323,229,718	79,703,491	-	-	14,030,023	52,608	-	417,015,840
Noninterest expenses:								
Salaries and fringe benefits	25,669,532	9,833,783					57,766	35,561,081
Depreciation and amortization	3,312,169	679,317			316			3,991,802
Occupancy and equipment costs	2,727,128	825,968		377	120			3,553,593
Legal and professional fees	3,558,219	1,771,436	4,705	38,421	1,128,270	2,400	30,366	6,533,817
Office and administrative	625,793	858,712	83,940					1,568,445
Subsidy and trustee fees		350,267						350,267
Provision for amount due from Puerto Rico Department of Housing		15,631,550						15,631,550
Credit for losses on guarantees and letters of credit	(12,710,970)				(3,745,114)			(16,456,084)
Credit for mortgage loan insurance		(1,161,748)						(1,161,748)
Net loss on derivatives	2,669,043							2,669,043
Other	7,021,643	2,575,545	-	483	105,331	500	7,988	9,711,490
Total noninterest expenses	32,872,557	31,364,830	88,645	39,281	(2,511,077)	2,900	96,120	61,953,256
Total operating expenses	356,756,111	113,137,608	88,645	39,281	13,971,021	55,508	96,120	484,144,294
OPERATING INCOME (LOSS)	85,959,830	(6,878,567)	4,220,095	6,666,212	5,601,145	23,315	(87,612)	95,504,418
NONOPERATING EXPENSES—Contributions to Cooperative Development Investment Fund and other	(4,892,396)	-	-	-	-	-	(2,500)	(4,894,896)
INCOME (LOSS) BEFORE TRANSFERS AND SPECIAL ITEMS	81,067,434	(6,878,567)	4,220,095	6,666,212	5,601,145	23,315	(90,112)	90,609,522
TRANSFER IN		25,928,610						25,928,610
TRANSFER OUT		(38,128,993)						(38,128,993)
SPECIAL ITEMS:								
Reimbursement of net guaranty disbursements from Commonwealth of Puerto Rico					21,497,903			21,497,903
Income from sponsored housing programs		18,039,373						18,039,373
Net loss on in-substance defeasance of bonds payable	-	(3,058,086)	-	-	-	-	-	(3,058,086)
CHANGE IN NET ASSETS	81,067,434	(4,097,663)	4,220,095	6,666,212	27,099,048	23,315	(90,112)	114,888,329
NET ASSETS–Beginning of year	1,219,961,219	531,859,830	70,286,623	34,054,183	98,353,890	1,030,168	294,672	1,955,840,585
NET ASSETS–End of year	$ 1,301,028,653	$ 527,762,167	$ 74,506,718	$ 40,720,395	$ 125,452,938	$ 1,053,483	$ 204,560	$ 2,070,728,914

See accompanying notes to basic financial statements.

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
CASH FLOWS FROM OPERATING ACTIVITIES:									
Cash received from interest on housing program loans	$ -	$ 9,455,930	$ -	$ -	$ -	$ -	$ -	$ -	$ 9,455,930
Cash paid for housing program loans originated		(74,371,297)							(74,371,297)
Principal collected on housing program loans		11,502,926							11,502,926
Proceeds from sale of housing program loans		36,123,147							36,123,147
Cash received from insurance premiums		2,759,875							2,759,875
Guarantee fees collected	12,710,970				3,432,737				16,143,707
Cash received from other operating non-interest revenues	10,457,571	12,005,265	603	6,998	664,387				23,134,824
Cash received from fiscal agency fees	8,145,123	278,785							8,423,908
Cash received from Commonwealth of Puerto Rico					21,497,903				21,497,903
Due to (from) governmental funds	(14,746,511)	146,128							(14,600,383)
Cash paid for insurance claims		(100,970)							(100,970)
Cash payments for other operating non-interest expenses	(16,235,870)	(6,782,868)	(89,460)	(39,030)	(1,161,944)	(2,750)	(13,527)	(2,578,345)	(26,903,794)
Cash payments for salaries and fringe benefits	(25,556,127)	(10,390,274)	-	-	-	-	-	-	(35,946,401)
Net cash provided by (used in) operating activities	(25,224,844)	(19,373,353)	(88,857)	(32,032)	24,433,083	(2,750)	(13,527)	(2,578,345)	(22,880,625)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:									
Contributions to others	(4,892,396)						(2,500)		(4,894,896)
Transfer in		25,928,610							25,928,610
Transfer out		(38,128,993)							(38,128,993)
Net increase (decrease) in:									
Deposits	1,259,868,237							(349,351,494)	910,516,743
Certificates of indebtedness	(212,600,000)								(212,600,000)
Securities sold under agreements to repurchase	315,966,000								315,966,000
Commercial paper	(206,181,422)								(206,181,422)
Proceeds from issuance of notes payable	1,728,853,325	246,832,932			26,182,555	303,023,792		(330,039,279)	1,974,853,325
Repayments of bonds and notes payable		(309,615,344)							(309,615,344)
Payment of bond issue costs		(3,393,907)							(3,393,907)
Cash paid for early extinguishment of bonds		(11,325,000)							(11,325,000)
Interest paid	(276,412,359)	(40,228,194)	-	-	(11,760,709)	-	-	(19,494,519)	(347,895,781)
Net cash provided by (used in) noncapital financing activities	2,604,601,385	(129,929,896)	-	-	14,421,846	303,023,792	(2,500)	(698,885,292)	2,093,229,335
NET CASH FLOWS USED IN CAPITAL AND RELATED FINANCING ACTIVITIES—Purchases of capital assets	(3,728,239)	(2,845,991)	-	-	-	-	-	-	(6,574,230)

See accompanying notes to basic financial statements

(Continued)

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
CASH FLOWS FROM INVESTING ACTIVITIES:									
Net decrease (increase) in:									
Federal funds sold	$ (524,000,000)	$ -	$ -	$ -	$ -	$ -	$ -	$	$ (524,000,000)
Deposits placed with banks	(163,557,870)	(48,050,038)			(27,112,538)	(303,023,792)		344,236,282	(197,507,956)
Purchases of investment securities	(821,012,523)	(372,615,776)	(25,670,631)		(25,292,892)			28,728,787	(1,215,863,035)
Proceeds from redemptions of investments	543,691,973	464,928,533	25,000,000		32,854,799			(37,229,588)	1,029,245,717
Proceeds from sales of investments	1,953,125			21,596,142					23,549,267
Interest and dividends received on investments	95,683,691	79,151,045	759,488	2,517,736	4,220,990	34,754	4,544	17,457,140	199,829,388
Interest received on other than housing program loans	161,149,532				12,320,417			2,037,380	175,507,329
Origination of other than housing program loans	(5,526,129,549)				(36,234,188)			330,039,279	(5,232,324,458)
Principal collected on other than housing program loans	3,223,392,210				300,740				3,223,692,950
Proceeds from sales of loans	395,029,738								395,029,738
Cash received from sponsored housing program		18,039,373							18,039,373
Net change in other assets		(774,064)							(774,064)
Net advances to Puerto Rico Department of Housing		(2,581,724)							(2,581,724)
Net proceeds and other cash collected related to foreclosed real estate held for sale	-	5,350,040	-	-	-	-	-	-	5,350,040
Net cash provided by (used in) investing activities	(2,613,799,673)	143,447,389	88,857	24,113,878	(38,942,672)	(302,989,038)	4,544	685,269,280	(2,102,807,435)
NET CHANGE IN CASH	(38,151,371)	(8,701,851)		24,081,846	(87,743)	32,004	(11,483)	(16,194,357)	(39,032,955)
CASH—At beginning of year	40,524,230	41,061,099	-	16,558,128	5,870,718	1,030,465	2,406,106	(38,984,047)	68,466,699
CASH—At end of year	$ 2,372,859	$ 32,359,248	$ -	$ 40,639,974	$ 5,782,975	$ 1,062,469	$ 2,394,623	$ (55,178,404)	$ 29,433,744
RECONCILIATION TO ENTERPRISE FUNDS BALANCE SHEET:									
Cash–unrestricted	$ 2,372,859	$ 5,140,058	$ -	$ 40,639,974	$ 5,782,975	$ 1,062,469	$ 2,394,623	$ (54,326,764)	$ 3,066,194
Cash–restricted	-	27,219,190	-	-	-	-	-	(851,640)	26,367,550
TOTAL CASH AT YEAR-END	$ 2,372,859	$ 32,359,248	$ -	$ 40,639,974	$ 5,782,975	$ 1,062,469	$ 2,394,623	$ (55,178,404)	$ 29,433,744

See accompanying notes to basic financial statements

(Continued)

Government Development Bank for Puerto Rico
(A COMPONENT UNIT OF THE COMMONWEALTH OF PUERTO RICO)

Statement of Cash Flows - Enterprise Funds
FOR THE YEAR ENDED JUNE 30, 2006

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:									
Operating income (loss)	$ 85,959,830	$ (6,878,567)	$ 4,220,095	$ 6,666,212	$ 5,601,145	$ 23,315	$ (87,612)	$	$ 95,504,418
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:									
Investment income	(106,666,223)	(86,995,559)	(759,915)	(4,475,391)	(4,463,631)	(78,823)	(8,508)		(203,448,050)
Interest income on other than housing program loans	(324,232,368)				(12,992,524)				(337,224,892)
Interest expense	323,229,718	79,703,491			14,030,023	52,608			417,015,840
Provision (credit) for loan losses	653,836	2,069,287			2,452,075				5,175,198
Credit for losses on guarantees and letters of credit	(12,710,970)				(3,745,114)				(16,456,084)
Provision for real estate losses		973,702							973,702
Provision for amount due from Puerto Rico Department of Housing		15,631,550							15,631,550
Provision for losses on other assets	3,270,631	87,373							3,358,004
Credit for estimated liability for mortgage insurance losses		(1,161,748)							(1,161,748)
Net decrease (increase) in fair value of investment	1,560,517	16,085,637	(3,548,221)	(2,223,482)	814,962				12,689,413
Net decrease in fair value of derivatives	29,529,212								29,529,212
Net increase in fair value of hedged item	(26,860,169)								(26,860,169)
Net gain on sales of real estate available for sale		(4,359,584)							(4,359,584)
Net gain on sales of loans		(1,922,339)							(1,922,339)
Reversal of contingency reserve		(4,254,594)							(4,254,594)
Reimbursement of net guaranty disbursements					21,497,903				21,497,903
Depreciation and amortization	3,312,169	679,317			316				3,991,802
Changes in operating assets and liabilities:									
Housing program loans receivable		(74,371,297)							(74,371,297)
Interest receivable on housing program loans		(428,595)							(428,595)
Decrease (increase) in other assets	17,935,798	(30,280)		251	1,570,203				19,475,972
Decrease (increase) in due from governmental funds	(14,746,511)	146,128							(14,600,383)
Collections of mortgage and construction loans		11,502,926							11,502,926
Proceeds from sale of housing program loans		36,123,147							36,123,147
Decrease in due to Commonwealth of Puerto Rico									
Decrease in estimated liability on mortgage insurance losses		(100,970)							(100,970)
Increase (decrease) in other liabilities	(5,460,314)	(1,872,378)	(816)	378	(332,275)	150	82,593	(2,578,345)	(10,161,007)
Net cash provided by (used in) operating activities	$ (25,224,844)	$ (19,373,353)	$ (88,857)	$ (32,032)	$ 24,433,083	$ (2,750)	$ (13,527)	$ (2,578,345)	$ (22,880,625)

See accompanying notes to basic financial statements

(Continued)

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Other Nonmajor	Eliminations	Total
NONCASH INVESTING AND NONCAPITAL FINANCING ACTIVITIES:									
Accretion of discount on investment securities and capitalized interest on investment securities	$ 10,006,761	$ 8,241,227	$ 975,479	$ -	$	$ -	$ -	$ (8,241,228)	$ 10,982,239
Capitalized interest on loans and other		721,573							721,573
Loans to foreclosed real estate available for sale	48,270,000	19,649							48,289,649
Undisbursed portion of construction loans		426,019							426,019
Origination of loans not requiring cash disbursement		2,320,365			26,000,000				28,320,365
Issuance of participation agreement payable					26,000,000				26,000,000
Accrued interest receivable on loan not collected					162,500				162,500
Accrued interest payable on participation agreement payable					162,500				162,500
Transfer of allowance for losses on guarantees and letters of credit to allowance for loan losses					2,901,500				2,901,500
Decrease of securities purchased under agreements to resell and related liabilities		240,000,000							240,000,000
Accretion (amortization) of discount (premium) on:									
Deposits	8,342,158							(8,241,228)	100,930
Certificate of indebtedness	6,428,297								6,428,297
Commercial paper	110,425								110,425
Bonds payable	(475,011)	36,631,014						(8,308,623)	27,847,380
Increase in fair value of hedged item	26,860,169								26,860,169
Decrease in fair value of derivative	(29,529,212)								(29,529,212)
Increase (decrease) in fair value of investments	(1,560,617)	(16,085,637)	3,548,221	2,223,482	(814,692)			(8,308,623)	(20,997,866)
Amortization of bond issue cost (included in interest expense)		3,575,596							3,575,596
Dividends reinvested				1,907,031					1,907,031

See accompanying notes to basic financial statements.

(Concluded)

Notes to Basic Financial Statements

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, 2006.

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 and purchased by low and moderate-income families. The Housing Finance Authority is authorized by the U.S. Department of Housing and Urban Development to administer the U.S. Housing Act Section 8 program in Puerto Rico and to act as an approved mortgagor, both for multifamily rental units and for single-family homes. In addition, it is an authorized issuer of Government National Mortgage Association ("GNMA") mortgage-backed securities, and is Puerto Rico's State Credit Agency for the Low-Income Housing Tax Credit Program under Section 42 of the U.S. Internal Revenue Code.

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

The Tourism Development Fund was created in 1993 to promote the hotel and tourism industry of the Commonwealth, primarily through the issuance of letters of credit and guarantees. The Tourism Development Fund is also authorized to make capital investments and provide direct financing to tourism-related projects.

The Development Fund was created in 1977 to expand the sources of financing available for the development of the private sector of the economy of Puerto Rico and to complement the Bank's lending program. The Development Fund may also guarantee obligations of private sector enterprises and invest in their equity securities.

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

The Capital Fund was created in 1992 to expand the investment options available to the Bank and to administer, separately from the Bank's general investment operations, an equity investments process through professional equity investment managers. In January 2002, the Bank's board of directors authorized an increase in the capitalization of the Capital Fund of up to 10% of the net assets of the Bank, as well as the adoption of a new investment strategy, which included the hiring of two additional portfolio managers to diversify the Capital Fund investments in the equity markets. As of June 30, 2006, 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.

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

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Government-wide and Fund Financial Statements

Government-wide Financial Statements—The statement of net assets and the statement of activities report information on all 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, 2006, has been reported only in the government-wide financial statements.
- Interest on general long-term obligations is generally recognized when paid.
- Debt service principal expenditures and claims and judgments are recorded only when payment is due.

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

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

In addition, the following nonmajor governmental funds are presented separately in the Bank's balance sheet and statement of revenues, expenditures and changes in fund balance:

- ***Affordable Housing Mortgage Subsidy Program (Stages 8 and 9)***—These special revenue funds are used to account for the proceeds of specific revenue sources under Stages 8 and 9 of the Affordable Housing Mortgage Subsidy Program ("AHMSP") that are legally restricted to expenditures to promote the origination of mortgage loans by financial institutions in the private sector to low and moderate-income families. These funds are two of the ten funds that are under the AHMSP of the Authority. Management has elected to present these nonmajor funds separately in the balance sheet and statement of revenues, expenditures and changes in fund balance to be consistent with their presentation in prior years.

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

- ***Affordable Housing Mortgage Subsidy Program (All except Stages 8 and 9)***—The AHMSP was created to promote the origination of mortgage loans to low and moderate-income families by financial institutions in the private sector. The program contemplates the issuance of bonds by trust activities of the enterprise funds and the receipt of advances from GDB to provide the funding to promote such loan originations.

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

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

- ***Interim Loan Insurance***—Up to June 30, 1989, the Puerto Rico Housing Bank and Finance Agency (the "Housing Bank"), which merged with and into the Housing Finance Authority during 2002, had an interim loan insurance program created by law to provide mortgage insurance to guarantee the payment of principal and interest on construction loans to developers of low and moderate-income housing units financed through other financial institutions. Due to the significant claims paid by this program in previous years, it no longer provides insurance coverage and is in the process of liquidating foreclosed real estate. This activity receives legislative appropriations, when needed, to repay the outstanding bond debt and derives its revenue from investment income and sales of the properties acquired through foreclosure.

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

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

Enterprise funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses are those that result from the Bank providing the services that correspond to their principal ongoing operations. Operating revenues are generated from lending, investing, banking and fiscal agency services, and other related activities. Operating expenses include interest expense, any provision for losses on loans, 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, 2006.

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.

Management believes that no losses will be incurred by the Bank with respect to principal and interest on loans to the public sector (including municipalities), and, as a result, 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 without a specific source of repayment being identified beforehand. The Act provides, however, for the Bank to originate new loans up to $100 million without specific sources of repayment with authorization in writing from both the Commonwealth's Governor and the Director of the OMB. In addition, on May 13, 2006, the Legislature enacted Act. No. 91, which provides that the first one percent of the new sales and consumption tax will be used to repay extra-constitutional debt of the Commonwealth, including approximately $2.8 billion of loans due by the Commonwealth and certain of its instrumentalities to the Bank.

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

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

Loans recorded in the governmental funds are presented at the outstanding unpaid principal balance reduced by 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. During the year ended June 30, 2003, the Tourism Development Fund initiated a process with the OMB to claim certain reimbursements for disbursements made under the guarantees in excess of fees and charges corresponding to fiscal years 2000 and 2002. In May 2006, the Tourism Development Fund received $21,497,903 in connection with this claim. Such amount is included as a special item in the accompanying statement of activities.

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

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—Statement of Financial Accounting Standards ("SFAS") No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, requires that loan origination and commitment fees and direct origination costs be amortized over the contractual life of the related loan. The Bank generally recognizes commitment fees as income when collected and the related loan origination costs as expense when incurred. In the opinion of management, the difference between the two methods does not have a significant effect on the Bank's financial position and changes in financial position.

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

Transfers of financial assets are accounted for as a sale, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the transferor, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the transferor does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity.

The Bank services loans for investors and receives servicing fees generally based on stipulated percentages of the outstanding principal balance of such loans. Loan servicing fees, late charges, and other miscellaneous fees are recognized as revenues as the related mortgage payments are collected, net of fees due to any third-party servicers. No servicing asset is recognized since fees are considered adequate compensation.

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

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

For all fair value hedging relationships, the Bank formally documents the hedging relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the 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 under SFAS No. 133 depends on the effectiveness of the hedge. To the extent these derivatives are effective in offsetting the variability of the hedged cash flows, SFAS No. 133 requires that changes in the derivatives' fair value be reported as other changes in equity, also known as other comprehensive income ("OCI"),

with these changes in fair value included in earnings of future periods when earnings are also affected by the variability of the hedged cash flows. However, in its guidance for the implementation of GASB Statement No. 34, GASB declared that the concept of OCI was not applicable to governmental entities and further indicated that any amounts which under FASB pronouncements were required to be recorded as changes to OCI should be reported in the statement of revenues, expenses, and changes in net assets under governmental accounting standards. Consequently, the Bank follows the provisions of SFAS No. 133, as modified by such GASB clarification, by recording on the balance sheet or statement of net assets, the fair value of derivatives intended to hedge the variability of cash flows to be received or paid related to a recognized assets or liability, but the change in fair value is reported in the statement of revenues, expenses, and changes in net assets.

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

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

Recently Adopted Accounting Pronouncements—During the year ended June 30, 2006, the Bank adopted the following accounting standards issued by the GASB:

- GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, which was effective for fiscal years beginning after December 15, 2004.
- GASB Statement No. 44, Economic Condition Reporting: The Statistical Section—An amendment of NCGA Statement 1, which was effective for statistical sections prepared for periods beginning after June 15, 2005.
- GASB Statement No. 46, Net Assets Restricted by Legislation, which was effective for periods beginning after June 15, 2005.
- GASB Statement No. 47, Accounting for Termination Benefits, which was effective for periods beginning after June 15, 2005.

The adoption of these statements did not have a material impact on the Bank's basic financial statements.

Future Adoption of Accounting Pronouncements—The GASB has issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions, which is effective for the Bank for periods beginning after December 15, 2007. Adoption of this statement 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, 2006. 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 $563 million mature within one year. Federal funds sold mature overnight and no collateral is required. As of June 30, 2006, $2,530,160,997 of the depository bank balance of $2,531,727,637 was uninsured and uncollateralized as follows:

	Carrying Amount	Depository Bank Balance	Amount Uninsured and Uncollateralized
Cash and due from banks	$ 34,168,372	$ 33,705,830	$ 32,139,190
Deposits placed with banks	563,021,807	563,021,807	563,021,807
Federal funds sold	1,935,000,000	1,935,000,000	1,935,000,000
Total	$ 2,532,190,179	$ 2,531,727,637	$ 2,530,160,997

Reconciliation to the government-wide statement of net assets:

Unrestricted:	
Cash and due from banks	$ 3,066,194
Deposits placed with banks	541,449,283
Federal funds sold	1,935,000,000
Total unrestricted	2,479,515,477
Restricted:	
Cash and due from banks	31,102,178
Deposits placed with banks	21,572,524
Total restricted	52,674,702
Total	$ 2,532,190,179

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 AAA by Moody's

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

The Bank's investment policies provide that investment transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by Standard & Poor's or equivalent rating by Fitch Ratings or Moody's Investors Service, depending on the type and maturity of the investment and the counterparty to the transaction. The investment policies also provide that purchases and sales of investment securities shall be made using the delivery vs. payment procedures.

The Bank's investment policies also provide that the Asset Liability Management Committee ("ALCO") is responsible for implementing and monitoring the Bank's interest rate risk policies and strategies. The ALCO meets on a monthly basis to coordinate and monitor the interest rate risk management of interest sensitive assets and interest sensitive liabilities, including matching of their anticipated level and maturities, consistent with the Bank's liquidity, capital adequacy, risk and profitability goals set by the Bank's board of directors and management.

The following table summarizes the type and maturities of investments held by the Bank at June 30, 2006. 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	$ 34,480,138	$ -	$ -	$ -	$ 34,480,138
U.S. Treasury notes		10,836,719			10,836,719
U.S. sponsored agencies notes—					
Federal Home Loan Bank ("FHLB")	99,583,988	288,317,723	279,042,000		666,943,711
Mortgage and asset-backed securities:					
Government National Mortgage Association ("GNMA")		116,122	11,758,108	496,356,841	508,231,071
Federal National Mortgage Association ("FNMA")	46,878	1,115,452	3,673,816	25,858,178	30,694,324
Federal Home Loan Mortgage Corporation ("FHLMC")	68,276	1,056,446	2,887,020	24,419,414	28,431,156
Chase Manhattan Auto Owners Trust	3,708,775				3,708,775
Other		5,424,187	1,504,005	965,687	7,893,879
Corporate debt:					
Popular North America	60,000,750				60,000,750
Morgan Stanley		24,182,575			24,182,575
General Electric		8,814,810			8,814,810
Other		1,883,820			1,883,820
External investment pools—					
Fixed-income securities	295,425,456				295,425,456
Nonparticipating investment contracts:					
CDC Funding		246,022,411		15,905,383	261,927,794
American International Group				228,400,329	228,400,329
Banco Popular de Puerto Rico				12,222,307	12,222,307
Other	41,068,000	701		163,396,931	204,465,632
Commonwealth agency bonds	-	-	-	3,770,000	3,770,000
Total investments	$ 534,382,261	$ 587,770,966	$ 298,864,949	$ 971,295,070	2,392,313,246
External investment pools—					
Equity securities:					
Russell 1000 Growth Common Trust Fund					49,975,358
Other					431,143
Total					$ 2,442,719,747
Reconciliation to the government-wide statement of net assets					
Unrestricted investments and investment contracts					$ 821,944,820
Restricted investments and investment contracts					1,620,774,927
Total					$ 2,442,719,747

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 $16,712,918 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, 2006, $10,698,630 of the Bank's investment in corporate debt maturing over one year of $34,881,205 bear a variable interest rate resetting quarterly at 100% of an interest rate index plus or minus a spread. Also, at June 30, 2006, approximately 96% of the Bank's investments in mortgage and asset-backed securities were held by trustees in connection with bonds issued by the Housing Finance Authority, the terms of which provide for early redemption of the bonds if the securities are early repaid.

All of the Bank's investments in U.S. Treasury securities and mortgage-backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government. The credit quality ratings for investments in debt securities, excluding U.S. Treasury securities and mortgage-backed securities guaranteed by GNMA, at June 30, 2006 are as follows:

	Credit Risk			
	Rating			
Securities type	**AAA to A**	**BBB+**	**Not Rated**	**Total**
U.S. sponsored agencies notes-FHLB	$ 666,943,711			$ 666,943,711
Mortgage and asset -backed securities:				
FNMA	30,694,324			30,694,324
FHLMC	28,431,156			28,431,156
Other	10,562,863		1,039,791	11,602,654
Corporate debt	34,881,205	60,000,750		94,881,955
External investment pools - Fixed-income securities	295,058,230		367,226	295,425,456
Nonparticipating investment contracts	707,016,062		-	707,016,062
Commonwealth agency bonds	-	3,770,000	-	3,770,000
Total	$ 1,773,587,551	$ 63,770,750	$ 1,407,017	$ 1,838,765,318

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

As of June 30, 2006, 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	$ 1,117,864,916
Securities sold under agreements to repurchase	515,000,000
Certificates of indebtedness	54,884,000
Interest rate swap agreements (notional amount)	120,000,000

5. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans at June 30, 2006 consist of the outstanding balance of credit facilities granted to the following (in thousands):

		Enterprise funds			
	Governmental Activities	GDB Operating Fund	Tourism Development Fund	Housing Finance Authority	Total
Public corporations and agencies	$ -	$ 6,308,633	$ -	$ -	$ 6,308,633
Municipalities	-	498,241	-	-	498,241
Total loans to public sector	-	6,806,874	-	-	6,806,874
Private sector	4,406	548	315,074	205,787	525,815
Allowance for loan losses	(657)	(281)	(34,000)	(17,290)	(52,228)
Total loans to private sector	3,749	267	281,074	188,497	473,587
Balance–end of year	$ 3,749	$ 6,807,141	$ 281,074	$ 188,497	$ 7,280,461

Reconciliation to the government-wide statement of net assets:	
Unrestricted loans receivable–net	$ 7,268,713
Restricted loans receivable–net	
Governmental activities	3,749
Business-type activities	7,999
Total	$ 7,280,461

Public sector loans amounting to approximately $1.8 billion as of June 30, 2006 were delinquent by 90 days or more, including approximately $11.9 million of loans classified as non-accrual. Interest income that would have been recorded if these loans had been accruing in accordance with their original terms was approximately $1.4 million in 2006. No interest was collected on these loans during the year ended June 30, 2006.

During the year ended June 30, 2006, the Bank charged-off two loans to a public entity amounting to approximately $1.8 million, which had been outstanding for more than ten years. These loans were charged-off after evaluating the legal implications of performing further collection efforts against the borrower. The Bank's management believes that other loans to public sector entities do not possess characteristics similar to the loans charged-off and, accordingly, believes that no allowance is required for the outstanding public sector loans at June 30, 2006.

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 $525.8 million at June 30, 2006 of which approximately $210.2 million are mortgage loans for low and moderate-income housing units and approximately $315.1 million are for tourism projects.

Private sector loans classified as non-accrual amounted to approximately $122.4 million at June 30, 2006. Interest income that would have been recorded if these loans had been performing in accordance with their original terms was approximately $11.6 million in 2006. Interest collected on these loans amounted to approximately $39 thousand for the year ended June 30, 2006.

The following is a summary of private sector loans of the enterprise funds considered to be impaired as of June 30, 2006, and the related interest income for the year then ended (in thousands):

	Enterprise funds			
	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Total
Recorded investment in impaired loans:				
Not requiring an allowance for loan losses	$ 210	$ -	$ -	$ 210
Requiring an allowance for loan losses	264	60,499	75,590	136,353
Total recorded investment in impaired loans	$ 474	$ 60,499	$ 75,590	$ 136,563
Related allowance for loan losses	$ 281	$ 5,811	$ 28,587	$ 34,679
Average recorded investment in impaired loans	1,035	59,041	75,590	135,666
Interest income recognized on impaired loans	39	-	-	39

The following is a summary of the activity in the allowance for loan losses for the year ended June 30, 2006 (in thousands):

		Enterprise Funds			
	Governmental Activities	GDB Operating Fund	Tourism Development Fund	Housing Finance Authority	Total
Balance–beginning of year	$ 311	$ 2,180	$ 31,548	$ 21,724	$ 55,763
Provision for loan losses	1,159	654	2,452	2,069	6,334
Charge-offs	(813)	(2,653)	-	(6,503)	(9,969)
Recoveries	-	100	-	-	100
Balance–end of year	$ 657	$ 281	$ 34,000	$ 17,290	$ 52,228

During the year ended June 30, 2006, the Housing Finance Authority sold approximately $34.2 million of single-family mortgage loans receivable. The net proceeds from the sale of these loans amounted to approximately $36.3 million, including $149,339 of accrued interest. The net gains from the sale of single family loans were approximately $1,922,339.

On December 22, 2005, the Bank sold, at par, loans and bonds of various municipalities amounting to $386.9 million to MFA. Also, on December 28, 2005, the Bank sold private sector loans to the Economic Development Bank for Puerto Rico, another component unit of the Commonwealth. The net proceeds from the sale of private sector loans were $8.1 million, including interest of $66,000.

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 amounted to approximately $6.8 billion or 53% of the Bank's government-wide total assets at June 30, 2006.

Many of the public sector loans are payable from legislative appropriations from 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 changes in these factors may have an adverse impact on the Bank's financial condition. During fiscal years 2003, 2004, 2005, and 2006, the Bank granted loans to the Commonwealth for $250 million, $233 million, $550 million, and $741 million, respectively, to cover the Commonwealth's budget deficit. As of June 30, 2006, the outstanding principal amount of the Bank loans granted to finance the Commonwealth's budget deficit was $1.8 billion.

During fiscal years 2003, 2004 and 2005, the Commonwealth's recurring expenditures exceeded its recurring revenues. These shortfalls were covered with loans from the Bank and other non-recurring revenues. Although the Commonwealth has implemented various revenue-enhancing and cost-reducing measures to bring expenditures in line with revenues, and expects these and other measures to balance its revenues and expenses by the end of fiscal year 2009, the Commonwealth's recurring expenditures for fiscal year 2006, are expected to exceed its recurring revenues.

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 Ba1 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 Ba1 rating on the Commonwealth's appropriation debt and removed the rating from Watchlist with negative implications. Moody's rating outlook, however, also remains negative.

In response to the Commonwealth's deficits over the last several fiscal years and the anticipated deficit for fiscal year 2006, during the second half of fiscal year 2005 and the first half of fiscal year 2006 the Commonwealth took certain legislative and executive actions aimed at establishing the basis for a comprehensive tax and fiscal spending reform. The combination of those actions, designed to increase recurring revenues and control government spending, is intended to eliminate the Commonwealth's structural budget deficit within several years. There is no assurance, however, that the structural imbalance will be corrected by such date. These actions, include, among other, establishment of government-wide expenditure controls that set forth the basic principles that would govern the reform of the Commonwealth's tax system and fiscal spending policy and practices, a tax reform aimed at increasing revenues by expanding the tax base through the implementation of a sales and consumption tax, and a fiscal reform aimed at limiting the growth of expenditures in relation to past spending rates and stabilizing expenditure growth to a level below that of recurring revenues.

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 is effective on November 15, 2006. Act 117 also imposes 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, 2006, approximately $2.8 billion of public sector loans are considered extra-constitutional debt subject to repayment from Sales Tax revenues collected by IIF.

In addition, on November 6, 2006, the Legislature approved House Bill No. 3163 to amend Act No. 91 and to create, among other things, the Puerto Rico Imperative Interest Fund Corporation ("PRIIFC") with the capacity to issue bonds or other mechanisms to repay or refinance extra-constitutional debt of the Commonwealth. PRIIFC will administer the IIF and will use the collections of the Sales Tax to repay or refinance the Commonwealth's extra-constitutional debt, including amounts due to the Bank and any obligations issued under any financing arrangement.

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 loans to the public sector will be collected, and that accordingly, no allowance for loan losses is needed at June 30, 2006.

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

The amount due from the federal government amounting to $18,043,192 at June 30, 2006 consists of the reimbursable share from FEMA of eligible costs incurred to plan, coordinate, and develop the construction of new housing as a replacement for those destroyed by Hurricane Georges in 1998, and to attend the housing needs of certain families living in flood zone areas in Puerto Rico. Amounts collected are subject to compliance audits under OMB Circular A-133 and federal granting agencies auditors. Management believes that it has complied with the terms of the grant and that all amounts claimed will be collected and, therefore, no allowance for uncollectible accounts has been established.

At June 30, 2006, the Housing Finance Authority has an amount due from the Puerto Rico Department of Housing amounting to $15,631,550, including accrued interest of $218,751. This balance consists of advances from four line of credit facilities. The approved amounts under these lines of credit are $3.2 million, $4 million, $10 million, and $50 million. Management has fully reserved this balance as of June 30, 2006.

7. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Additions	Reductions/ Reclassifications	Ending Balance
Capital assets not being depreciated:				
Land	$ 2,845,000	$ -	$ -	$ 2,845,000
Construction in progress	9,753,214	948,097	-	10,701,311
Total capital assets not being depreciated	12,598,214	948,097	-	13,546,311
Capital assets being depreciated:				
Building	8,988,048	-	-	8,988,048
Leasehold improvements	459,264	2,197,992	(314,378)	2,342,878
Information systems	4,667,493	528,165	(436,825)	4,758,833
Office furniture and equipment	3,058,337	433,095	(618,560)	2,872,872
Software	2,276,218	2,450,605	(53,355)	4,673,468
Vehicles	506,184	16,276	(91,373)	431,087
Total capital assets being depreciated	19,955,544	5,626,133	(1,514,491)	24,067,186
Less accumulated depreciation and amortization for:				
Building	(1,011,155)	(224,701)	-	(1,235,856)
Leasehold improvements	(165,109)	(458,914)	314,378	(309,645)
Information systems	(3,472,051)	(773,685)	436,825	(3,808,911)
Office furniture and equipment	(1,955,530)	(494,230)	618,560	(1,831,200)
Software	(367,692)	(1,984,614)	53,355	(2,298,951)
Vehicles	(305,040)	(55,658)	91,373	(269,325)
Total accumulated depreciation and amortization	(7,276,577)	(3,991,802)	1,514,491	(9,753,888)
Total capital assets being depreciated–net	12,678,967	1,634,331	-	14,313,298
Total capital assets–net	$ 25,277,181	$ 2,582,428	$ -	$ 27,859,609

Construction in progress represents costs incurred up to June 30, 2006 for the new headquarters of the Bank. These headquarters are being constructed in parcels of land currently owned by another agency of the Commonwealth. In January 2004, the Bank entered into an agreement with such agency whereby the Bank will transfer a property currently owned by the Bank with a similar fair value, recorded as part of real estate owned available for sale, in exchange for the parcels of land owned by the agency. Management of the Bank expects to complete the transfer during 2007.

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 $184 million in 2006.

9. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

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

Carrying amount at June 30, 2006	$515,000,000
Maximum amount outstanding at any month-end	610,673,000
Average amount outstanding during the year	508,834,781
Weighted average interest rate for the year	4.01%
Weighted average interest rate at year-end	4.69%

The Housing Finance Authority was designated by the Office of the Commissioner of Financial Institutions of the Commonwealth (the "Commissioner") as an eligible similar institution under Puerto Rico Regulation 5105. This regulation allowed the Authority to receive up to $250 million in eligible funds (commonly known as 936 tax-exempt funds), which were received through securities sold under agreements to repurchase and were used for an arbitrage program. The Housing Finance Authority's participation in this program was terminated effective January 2006, upon expiration of the U.S. Internal Revenue Code Section 936.

The maturities of the investments made with proceeds obtained from the securities sold under agreements to repurchase were matched with the maturities of such obligations.

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

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

During the year ended June 30, 2006, this arbitrage program generated a net interest income of $14,751.

The following summarizes the activity of securities sold under agreements to repurchase for the year ended June 30, 2006:

	Beginning Balance	Issuances	Maturities	Ending Balance
GDB Operating Fund	$ 199,034,000	$ 2,262,423,917	$ 1,946,457,917	$ 515,000,000
Housing Finance Authority	240,000,000	108,000,000	348,000,000	-
Total	$ 439,034,000	$ 2,370,423,917	$ 2,294,457,917	$ 515,000,000

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, 2006, securities sold under agreements to repurchase mature within five years.

10. COMMERCIAL PAPER

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

The following summarizes the commercial paper activity for fiscal year 2006:

	Balance	Issuances	Accretion	Maturities	Balance	One Year
GDB Operating Fund	$ 1,191,202,415	$ 13,145,400,086	$ 110,425	$ 13,351,581,508	$ 985,131,418	$ 985,131,418

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, 2006:

	Beginning Balance	Issuances	Discount Accretion	Maturities	Ending Balance	Due Within One Year
GDB Operating Fund	$ 261,055,703	$ 7,500,000	$ 6,428,297	$ 220,100,000	$ 54,884,000	$ 47,384,000

At June 30, 2006, certificates of indebtedness amounting to approximately $47.4 million contractually mature during the fiscal year ending 2007 and approximately $7.5 million contractually mature during fiscal year ending June 30, 2011.

12. BONDS AND NOTES PAYABLE AND OTHER LIABILITIES

The activity of bonds payable and other borrowed funds for the year ended June 30, 2006 is as follows:

	Beginning Balance	Debt Issued	Debt Paid	Reductions	Ending Balance	Due Within One Year
Governmental activities:						
Commonwealth appropriation bonds and notes:						
Law 115—Subsidy prepayment refunding bonds	$ 60,995,000	$ -	$ (28,595,000)	$ -	$ 32,400,000	$ 32,400,000
Note payable—Affordable Housing Mortgage Subsidy Program Stage 7	10,339,331		(95,748)		10,243,583	45,047
Total Commonwealth appropriation appropriation bonds and notes	71,334,331		(28,690,748)		42,643,583	32,445,047
General obligation bonds— Loan insurance claims refunding bonds	17,075,000	-	(7,825,000)	-	9,250,000	9,250,000
Total governmental activities	$ 88,409,331	$ -	$ (36,515,748)	$ -	$ 51,893,583	$ 41,695,047

	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	$ -
GDB Senior Notes Series A		885,000,000		885,000,000	
GDB Senior Notes Series B		740,000,000		740,000,000	37,180,000
GDB Senior Notes Series C		81,960,000		81,960,000	-
Add unamortized premium		21,893,325	(475,011)	21,418,314	4,247,559
Unrealized gain on fair value hedge	-	-	(26,860,169)	(26,860,169)	-
Total GDB Operating Fund	267,000,000	1,728,853,325	(27,335,180)	1,968,518,145	41,427,559
Housing Finance Authority:					
Mortgage Trust III	1,120,523,874	-	(43,310,000)	1,077,213,874	43,240,000
Revenue bonds:					
Collateralized Mortgage Revenue Bonds	61,675,000		(7,375,000)	54,300,000	625,000
Single Family Mortgage Revenue Bonds—Portfolio I	42,660,000		(830,000)	41,830,000	765,000
Single Family Mortgage Revenue Bonds—Portfolio II	6,500,000		(6,500,000)	-	
Single Family Mortgage Revenue Bonds—Portfolio III	4,030,000		(2,550,000)	1,480,000	10,000
Single Family Mortgage Revenue Bonds—Portfolio IV	59,663,000		(957,000)	58,706,000	1,016,000
Single Family Mortgage Revenue Bonds—Portfolio IX	347,325,000		(214,820,000)	132,505,000	2,195,000
Single Family Mortgage Revenue Bonds—Portfolio X		246,000,000		246,000,000	
Mortgage Trust IV—Collateralized mortgage obligations	25,099,715		(17,968,344)	7,131,371	
Homeownership Mortgage Revenue Bonds 2000	75,820,000		(9,625,000)	66,195,000	1,275,000
Homeownership Mortgage Revenue Bonds 2001	79,830,000		(8,055,000)	71,775,000	1,375,000
Homeownership Mortgage Revenue Bonds 2003	35,515,000	-	(3,030,000)	32,485,000	1,960,000
Total revenue bonds	738,117,715	246,000,000	(271,710,344)	712,407,371	9,221,000
Subtotal	1,858,641,589	246,000,000	(315,020,344)	1,789,621,245	52,461,000
Notes payable to GDB and other financial institutions	21,474,629	832,932		22,307,561	22,307,561
Less unaccreted discount	639,824,303	-	(36,631,014)	603,193,289	-
Total Housing Finance Authority	1,240,291,915	246,832,932	(278,389,330)	1,208,735,517	74,768,561
Tourism Development Fund:					
Participation agreement payable		26,000,000		26,000,000	
Notes payable to GDB	233,686,876	26,182,555	-	259,869,431	305,000
Total Tourism Development Fund	233,686,876	52,182,555	-	285,869,431	305,000
Public Finance Corporation—Note payable to GDB	-	303,023,792	-	303,023,792	10,100,793
Total	1,740,978,791	2,330,892,604	(305,724,510)	3,766,146,885	126,601,913
Less intrafund eliminations	(339,525,631)	(330,039,279)	(8,308,623)	(677,873,533)	(15,173,063)
Total business-type activities	$ 1,401,453,160	$ 2,000,853,325	$ (314,033,133)	$ 3,088,273,352	$ 111,428,850

The annual debt service requirements to maturity, including principal and interest, for long-term debt, other than notes payable to financial institutions, as of June 30, 2006, are as follows:

Year Ending June 30	GDB Operating Fund Business-Type Activities Principal	Interest
2007	$ 37,180,000	$ 67,337,800
2008	108,800,000	71,788,450
2009	92,915,000	71,054,050
2010	72,450,000	70,030,800
2011	63,295,000	69,573,050
2012-2016	684,490,000	380,576,225
2017-2021	29,830,000	259,608,250
2022-2026		258,862,500
2027-2031	885,000,000	243,481,875
Total	$ 1,973,960,000	$ 1,492,313,000

Year Ending	Housing Finance Authority			
	Governmental Activities		Business-type Activities	
June 30	Principal	Interest	Principal	Interest
2007	$ 41,695,047	$ 1,785,564	$ 52,461,000	$ 38,876,003
2008	38,504	569,260	57,195,000	38,370,536
2009	150,768	562,122	57,735,000	37,740,503
2010	159,040	553,776	56,875,000	37,077,427
2011	150,872	545,427	57,110,000	36,375,193
2012-2016	985,349	2,456,604	284,302,561	168,706,542
2017-2021	1,501,167	1,971,634	275,020,982	140,625,401
2022-2026	1,855,284	1,440,967	650,539,659	105,239,072
2027-2031	4,239,119	733,573	162,052,714	61,023,772
2032-2036	1,118,432	-	112,544,330	21,160,314
2037-2041	-	-	23,785,000	1,244,295
Total	$ 51,893,583	$ 10,618,927	$ 1,789,621,245	$ 686,439,058

Year Ending June 30	Tourism Development Fund Business-Type Activities Principal	Interest
2007	$ -	$ 1,977,083
2008	-	1,977,083
2009	26,000,000	655,417
Total	$ 26,000,000	$ 4,609,583

Governmental Activities

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

Description and Maturity Date	Interest Rate	Amount Outstanding
Commonwealth appropriation bonds and notes:		
Subsidy Prepayment Refunding Bonds:		
December 1, 2002 and each December 1 thereafter to December 1, 2006	5.125%-7.50%	$ 32,400,000
Loan Insurance Claims Refunding Bonds:		
December 1, 2002 and each December 1 thereafter to December 1, 2006	5.125%-5.25%	9,250,000
Note payable Affordable Housing Mortgage Subsidy Program Stage 7:		
July 1, 2005 and each July 1 thereafter to July 1, 2031	4.10%-5.25%	10,243,583
Total governmental activities bonds and notes payable		$ 51,893,583

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

Note Payable to Puerto Rico Public Finance Corporation—On December 27, 2001, the Housing Finance Authority entered into a loan agreement (the "Note") with the GDB Operating Fund to refinance the Affordable Housing Mortgage Subsidy Program Stage 7 note payable (the "Old Note") of the Housing Bank, as authorized by Act No. 164 of December 17, 2001. The Public Finance Corporation acquired and restructured the Note through the issuance of its Commonwealth appropriations bonds ("PFC Bonds"). The PFC Bonds were issued under a trust indenture whereby the Public Finance Corporation pledged and sold the Note, along with other notes under Act No. 164, to certain trustees and created a first lien on the revenues of the notes sold. The notes payable to the Public Finance Corporation were originally composed of a loan granted by the Bank, which, pursuant to Act No. 164 of December 17, 2001, the Public Finance Corporation acquired and restructured through the issuance of Commonwealth appropriation bonds. These bonds were issued under trust indenture agreements whereby the Public Finance Corporation pledged the notes to certain trustees and created a first lien on the pledged revenue (consisting of annual Commonwealth appropriations earmarked to repay these notes) for the benefit of the bondholders.

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

The Note's outstanding balance at June 30, 2006 was $10,243,583 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 and notes payable by business-type activities consist of the following:

Description and Maturity Date	Interest Rate	Amount Outstanding
Adjustable Refunding Bonds:		
December 1, 2015	Variable, 3.87% at June 30, 2006	$ 267,000,000
GDB Senior Notes :		
Series A—March 1, 2031 and April 1, 2031	5.85%	858,139,831
Series B—December 1, 2006 and each December 1 thereafter to December 1, 2017	4.125%-5.00%	757,831,716
Series C—January 1, 2015	5.25%	85,546,598
Mortgage Trust III:		
January 1, 2001 and each July 1 and January 1 thereafter to July 1, 2011	Zero Coupon	122,661,210
January 1, 2001 and each July 1 and January 1 thereafter to January 1, 2021	Zero Coupon	241,146,335
Collateralized Mortgage Revenue Bonds:		
January 1, 2005 and each January 1 and July 1 thereafter to January 1, 2029	6.10%-6.50%	54,300,000
Single Family Mortgage Revenue Bonds – Portfolio I:		
October 1, 2002 and each April 1 and October 1 thereafter to April 1, 2029	5.55%-6.25%	41,830,000
Single Family Mortgage Revenue Bonds – Portfolio III:		
August 1, 2005 and each February and August 1 thereafter to August 1, 2029	6.20%-7.00%	1,480,000
Single Family Mortgage Revenue Bonds – Portfolio IV:		
December 1, 2005 and each June 1 and December 1 thereafter to December 1, 2030	5.95%-6.25%	58,706,000
Single Family Mortgage Revenue Bonds – Portfolio IX:		
June 1, 2005 and each December 1 and June 1 thereafter to December 1, 2012	3.60%-5.60%	132,505,000
Single Family Mortgage Revenue Bonds – Portfolio X:		
December 1, 2007 and each December 1 and June 1 thereafter to December 1, 2037	4.15%-5.65%	246,000,000
Mortgage Trust IV - August 1, 2009	6.00%	7,131,371
Homeownership Mortgage Revenue Bonds 2000 Series:		
December 1, 2002 and each June 1 and December 1 thereafter to December 1, 2032	4.20%-5.20%	66,195,000
Homeownership Mortgage Revenue Bonds 2001 Series:		
December 1, 2002 and each December 1 thereafter to December 1, 2012	3.875%-4.70%	60,745,000
June 1, 2013 and each December 1 and June 1 thereafter to December 1, 2033	4.45%-5.50%	11,030,000
Homeownership Mortgage Revenue Bonds 2003 Series:		
December 1, 2005 and each December 1 thereafter to December 1, 2013	2.10%-4.00%	5,460,000
June 1, 2013 and each December 1 and June 1 thereafter to December 1, 2033	4.375%-4.875%	27,025,000
Total		$ 3,044,733,061

On April 10, 2006, the Housing Finance Authority issued $246,000,000 Single Family Mortgage Revenue Bonds, Portfolio X (the "Portfolio X Bonds") consisting of serial bonds and term bonds amounting to $40,560,000 and $205,440,000 respectively. The proceeds from these bonds were used to provide funds for the purchase and transfer to a trustee of mortgaged-backed securities guaranteed by GNMA, FNMA or FHLMC (collectively, the "Mortgage Certificates-Portfolio X"). The Mortgage Certificates-Portfolio X are backed by pools of mortgage loans made by participating lending institutions to low and moderate-income families to finance the purchase of qualified single-family residential housing in Puerto Rico. The Portfolio X Bonds maturing on or after June 1, 2011 are subject to redemption in whole or in part, at the option of the Housing Finance Authority, prior to their stated maturity at the following redemption prices:

Redemption Period	Redemption Price
June 1, 2011 to May 31, 2012	102%
June 1, 2012 to May 31, 2013	101%
June 1, 2013 and thereafter	100%

On January 31, 2006, the Housing Finance Authority entered into a Deed of Escrow Deposit Agreement (the "Agreement") with a financial institution (the "Escrow Agent") to deposit available moneys for the repayment of outstanding balance of its Affordable Housing Mortgage Subsidy Program, Portfolio II Bonds (the "Portfolio II Bonds") amounting to $9,175,000. As part of the Agreement, the Housing Finance Authority contributed $11,325,000 to an escrow account from which the Escrow Agent will irrevocably pay the debt service requirements of the Portfolio II Bonds on each scheduled payment date, without any option to redeem them prior to their stated maturities. As a result, the outstanding balance of the Portfolio II Bonds at June 30, 2006 is considered to be defeased in-substance and, accordingly, has been excluded from the accompanying balance sheet—enterprise funds. The difference between the carrying amount of the outstanding Portfolio II Bonds at the time of the in-substance defeasance and the amount contributed to the escrow account of $3,058,086 has been presented as a special item—net loss on in substance defeasance of bonds payable in the accompanying statements of activities and of revenues, expenses and changes in net assets—enterprise funds. The outstanding balance of the in-substance defeased Portfolio II Bonds amounted to $9,175,000 at June 30, 2006.

In December 2002, the Housing Finance Authority entered into a non-revolving credit facility (the "Facility") with a commercial bank in the aggregate principal amount of up to $50 million to provide funds to the Puerto Rico Department of Housing for the rehabilitation and redevelopment of the Santurce sector of the Municipality of San Juan (the "Project"). Under this Project, approximately 159 properties (the "Target Properties") were identified and are intended to be or were acquired through purchase or expropriation, for sale to persons that will develop, re-develop, and/or construct, commercial and residential projects. The acquisition and sale of the Target Properties have been undertaken through the Puerto Rico Department of Housing under Act No. 201 of the Legislature dated August 26, 2002. Therefore, the Puerto Rico Department of Housing, not the Housing Finance Authority, will own all the Target Properties acquired under the Project. At June 30, 2006, the Facility has an outstanding balance of $5,840,291, maturing in December 2006. The Facility bears a variable interest consisting of the 30-day London Interbank Offered Rate ("LIBOR") plus 0.50% at the first day of each month (5.62938% at June 30, 2006). The Housing Finance Authority is obligated, under this credit agreement, to prepay the advances of the Facility upon the sale or disposition of all or any part of the mortgaged Target Properties in the amount of 100% of the net proceeds.

On April 28, 2005, the Housing Finance Authority entered into a credit facility with another commercial bank to increase the availability of funds to the Puerto Rico Department of Housing. This facility consists of a non-revolving line of credit in an aggregate principal amount not to exceed $12,200,000. Advances made under this facility were used to refinance existing loans and to pay costs and expenses related to the transaction. At June 30, 2006, this facility has an outstanding balance of $11,700,000 maturing in April 2007. This facility bears interest at a variable rate consisting of the 30-day LIBOR plus 0.35% at the first day of each month (5.47938% at June 30, 2006) and payable quarterly in arrears on the first business day of each quarter (July 1st, October 1st, January 1st and April 1st).

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 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 secured borrowing) in the accompanying balance sheet—enterprise funds.

The Note bears interest at 30-day LIBOR plus 2% (7.5% as of June 30, 2006) payable on a monthly 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, 2006.

The activity for noncurrent accrued and other liabilities during the year ended June 30, 2006 follows:

Balance–beginning of period	$ 3,423,354
Additions	39,527,228
Balance–end of period	$ 42,950,582

The activity for compensated absences, included within accounts payable and accrued liabilities, during the year ended June 30, 2006 follows:

	Balance	Provision	Reductions	Balance	Due Within One Year
Vacation	$ 2,955,577	$ 2,072,679	$ 2,212,768	$ 2,815,488	$ 2,107,887
Sickness	2,664,291	1,347,005	1,570,698	2,440,598	1,438,823
Total	$ 5,619,868	$ 3,419,684	$ 3,783,466	$ 5,256,086	$ 3,546,710

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, 2006, the Housing Finance Authority had restricted net assets for such purposes of approximately $43.8 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, 2006, the off-balance-sheet risks consisted of the following (in thousands):

Financial instruments whose credit risk is represented by contractual amounts:	
Financial guarantees to:	
Public sector	$ 125,000
Private sector	29,035
Total	$ 154,035
Standby letters of credit:	
Public sector	$ 113,296
Private sector	126,606
Total	$ 239,902
Commitments to extend credit:	
Public sector	$ 3,517,737
Private sector	22,123
Total	$ 3,539,860

Financial guarantees and letters of credit outstanding at June 30, 2006 include approximately $130 million issued by the Tourism Development Fund on several private hotel and tourism development projects.

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

The service contract between Ondeo and PRASA was cancelled on January 15, 2005. It was agreed, as part of the negotiations, that each party will issue a reciprocating letter of credit, for a maximum of $37.5 million, in exchange for the cancellation of the previous payment guarantee.

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

The Bank issued a letter of credit in favor of Ondeo effective as of July 1, 2006 with an expiration date of June 30, 2007 in the amount of $8.9 million, which represent the aggregate amount of Ondeo's Claims for Indemnification against PRASA.

Following is the activity for the noncurrent portion of the allowance for losses on guarantees and letters of credit for the year ended June 30, 2006:

	Beginning Balance	Credit	Recoveries	Ending Balance
GDB Operating Fund	$ 1,000,000	$ (12,710,970)	$ 12,710,970	$ 1,000,000
Tourism Development Fund	5,269,360	(3,745,114)	-	1,524,246
Total	$ 6,269,360	$ (16,456,084)	$ 12,710,970	$ 2,524,246

15. DERIVATIVE INSTRUMENTS

The Bank has entered into several interest rate exchange agreements (swaps) to manage its exposure in certain debt instruments as follows:

- Interest rate exchange agreements to convert its variable rate bonds to fixed rate.
- Interest rate exchange agreements to convert a portion of its variable rate demand deposit portfolio to fixed rate.
- Interest rate exchange agreements to hedge the changes in fair value of certain notes payable.

At June 30, 2006, the Bank was a party to the following interest-rate swap agreements (notional amount and fair value in thousands):

Notional Amount	Floating Rate Indicator	Rate at June 30, 2006				Maturity Date	Fair Value June 30, 2006
		Receives		Pays			
		Type	Rate	Type	Rate		
$ 50,000	3m LIBOR – 0.75	Variable	4.25%	Fixed	4.715%	July 1, 2006	$ (19)
60,000	3m LIBOR – 0.75	Variable	4.25%	Fixed	4.710%	July 1, 2006	(23)
60,000	3m LIBOR – 0.75	Variable	4.25%	Fixed	4.710%	July 1, 2006	(20)
267,000	VRDOs(1)	Variable	3.87%	Fixed	3.040%	August 1, 2007	1,149
125,000	1m LIBOR	Fixed	6.23%	Variable	5.109%	March 1, 2031	(5,667)
250,000	1m LIBOR	Fixed	6.23%	Variable	5.109%	March 1, 2031	(11,333)
125,000	1m LIBOR	Fixed	6.23%	Variable	5.109%	March 1, 2031	(5,667)
100,000	1m LIBOR	Fixed	6.23%	Variable	5.109%	April 1, 2031	(4,543)
100,000	1m LIBOR	Fixed	6.23%	Variable	5.109%	April 1, 2031	(4,543)
185,000	1m LIBOR	Fixed	6.23%	Variable	5.109%	April 1, 2031	(8,405)
$ 1,322,000							$ (39,071)

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

On February 2, 2006, the Bank entered into various interest swap agreements with counterparties in connection with the issuance of its Senior Notes Series A (the "Senior Notes"). Under the terms of these agreements, the Bank receives fixed interest rate payments and makes floating rate payments, effectively converting the Senior Notes to a floating rate LIBOR based debt. The interest rate swap agreements may be terminated by the counterparties no earlier than March 1, 2007 and quarterly thereafter, matching the call option the Bank has on the Senior Notes.

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

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

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

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

16. RETIREMENT SYSTEM

Defined Benefit Pension Plan

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

The Retirement System provides retirement, death, and disability benefits pursuant to legislation enacted by the Legislature. 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, 2006 amounted to approximately $1,769,321. The Bank's contributions during the years ended June 30, 2006, 2005, and 2004 amounted to approximately $2,242,458, $1,864,000 and $1,733,000, respectively. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the Retirement System itself.

Additional information on the Retirement System is provided in its stand-alone financial statements for the year ended June 30, 2006, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities, PO Box 42005, San Juan, PR 00940-2005.

17. 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. Rent charged to operations in fiscal year 2006 amounted to approximately $1.4 million. At June 30, 2006, the minimum annual future rentals under noncancelable leases are as follows:

Year Ending June 30	Amount
2007	$ 688,000
2008	402,000
2009	399,000
2010	413,000
2011	428,000
Total	$ 2,330,000

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, 2006, the Bank has contributed $10.8 million to the Cooperative Development Investment Fund, $3.6 million of which were contributed during the year ended June 30, 2006.

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, 2006, outstanding guarantees amounted to approximately $672,000.

Custodial Activities of Enterprise Funds

At June 30, 2006, the Housing Finance Authority was custodian of $110,393 in restricted funds of CRUV. As of June 30, 2006, such funds are deposited with the Bank. These funds are not owned by the Housing Finance Authority's enterprise funds and thus are not reflected in the basic financial statements.

At June 30, 2006, the Authority was the custodian of approximately $17,580 designated for the improvements to be made to the Puerto Rico Department of Housing building. The Authority's management has included these funds in the enterprise fund as an asset, included within cash and due from banks, and a liability to the Puerto Rico Department of Housing.

Loan Sales and Securitization Activities

On July 13, 1992, the Housing Bank entered into an agreement to securitize approximately $20.7 million of mortgage loans into a FNMA certificate. The Housing Finance Authority agreed to repurchase, at a price of par plus accrued interest, each and every mortgage loan backing up such security certificate that became delinquent for 120 days or more. As of June 30, 2006, the aggregate outstanding principal balance of the loans pooled into the FNMA certificate amounted to $896,370.

Mortgage Loan Servicing Activities

The Housing Finance Authority acts as service for a number of mortgage loans owned by other investors. The servicing is generally subcontracted to a third party. As of June 30, 2006, the principal balance of the mortgage loans serviced for others is as follows:

Popular Mortgage, Inc.	$ 18,091,289
R-G Mortgage, Inc.	8,858,707
CRUV or its successor without guaranteed mortgage loan payments	67,279
Other investors, with guaranteed mortgage loan payments	274,269
Total	$ 27,291,544

Litigation

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

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

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

18. 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, 2006 amounted to approximately $4.4 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 of the Commonwealth enacted by Act No. 91, which created the Imperative Interest Fund (the "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 of the Commonwealth. 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 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.

Certain bonds of the Housing Finance Authority are considered no-commitment debt as more fully described in Note 2. At June 30, 2006, 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	$ 18,254,952
Restricted liabilities (no-commitment debt)	16,609,356
Restricted fund balance	$ 1,645,596
Excess of fund expenses over revenues	$ (17,591,413)

During the year ended June 30, 2006, the Authority received $18,039,373 representing its residual interest after the early repayment of no-commitment debt. Such amount has been recorded as a special item—income from sponsored housing programs in the accompanying statements activities and of revenues, expenses and changes in net assets—enterprise funds.

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 $641 million at June 30, 2006.

Housing Act Section 8 Program in Puerto Rico. The revenues and expenses of such federal financial assistance are accounted for as a major governmental fund under HUD Programs. Revenues and expenditures related to the administration of the U.S. Housing Act Section 8 Program amounted to $114,432,009 for the year ended June 30, 2006. This amount excludes $5,124,082 of administrative fees for services performed as contract administrator, which are reimbursed by the U.S. Department of Housing and Urban Development.

19. 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, 2006, 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 to these financial instruments, as such information may not be estimated with reasonable precision.

- Disclosure of the fair value of commitments to extend credit, standby letters of credit, and financial guarantees relating to instrumentalities of the Commonwealth is omitted, as these arrangements are with component units of the Commonwealth.

- Interest rate swaps were valued using estimated market prices, based on discounted future cash flows.

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at June 30, 2006:

	Reported or Notional Amount	Fair Value
	(In millions)	
Financial assets:		
Cash and due from banks	$ 34	$ 34
Federal funds sold	1,935	1,935
Deposits placed with banks	563	559
Due from federal government	18	18
Investments and investment contracts	2,443	2,472
Loans to public sector	6,807	6,800
Accrued interest receivable and other receivable	305	305
Financial liabilities:		
Demand deposits	2,047	2,047
Certificates of deposit	3,736	3,736
Certificates of indebtedness	55	55
Securities sold under agreements to repurchase	515	515
Commercial paper	985	985
Accounts payable and accrued liabilities	114	114
Accrued interest payable	56	56
Bonds, notes, and participation agreement payable	3,140	3,096
Derivative instruments:		
Interest rate exchange agreements	1,322	(39)

20. INTERFUND BALANCES AND TRANSFERS

The following table is a summary of the interfund balances as of June 30, 2006 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	$ 9,999,926
HUD Programs	GDB Operating Fund	Demand deposits and accrued interest	136,639
Other Nonmajor Funds (Interim Loan Insurance)	GDB Operating Fund	Demand deposits and accrued interest	53,229
Subsidy Prepayment Refunding Bonds—Debt Service	GDB Operating Fund	Demand deposits and accrued interest	478,888
Other Nonmajor Funds (AHMSP Law 124)	GDB Operating Fund	Certificates of deposit and accrued interest	1,056,390
Affordable Housing Mortgage Subsidy Program-Stage 8	GDB Operating Fund	Demand deposits and accrued interest	73,841
Affordable Housing Mortgage Subsidy Program-Stage 8	GDB Operating Fund	Investment agreements and accrued interest	19,417,752
Other Nonmajor Funds (Special Obligation Refunding Bonds)	GDB Operating Fund	Certificates of deposit and accrued interest	3,988,739
Other Nonmajor Funds (Special Obligation Refunding Bonds)	GDB Operating Fund	Demand deposits and accrued interest	1,874,330
Other Nonmajor Funds (AHMSP Portfolio Law 124)	GDB Operating Fund	Demand deposits and accrued interest	(47,305)
The Key for your Home Program	GDB Operating Fund	Certificates of deposit and accrued interest	17,591,124
The Key for your Home Program	GDB Operating Fund	Demand deposits and accrued interest	402,986
Subtotal and balance carried forward			55,026,539

Receivable by	Payable by	Purpose	Amount
Balance brought forward			$ 55,026,539
Governmental fund:	**Enterprise fund:**		
New Secure Housing Program	Housing Finance Authority	Reimbursement of expenditures	2,663,329
Other nonmajor Funds (AHMSP Portfolio IV)	Housing Finance Authority	Reimbursement of bond issue costs	2,527,427
Other Nonmajor Funds (Special Obligation Refunding Bonds)	Housing Finance Authority	Reimbursement of loan originations	131,362
The Key for Your Home Program	Housing Finance Authority	Advances	20,083
Subtotal			5,342,201
Total			60,368,740
Enterprise fund:	**Governmental fund:**		
GDB Operating Fund	New Secure Housing Program	Loans payable and accrued interest	(34,445,307)
GDB Operating Fund	Other Nonmajor Funds (AHMSP Stage 7)	Securities purchased under agreements to resell and accrued interest	(53,330,930)
GDB Operating Fund	Affordable Housing Mortgage Subsidy Program—Stage 9	Loans payable and accrued interest	(69,842,835)
GDB Operating Fund	Other Nonmajor Funds (AHMSP Stage 10)	Loans payable and accrued interest	(13,747,715)
Housing Finance Authority	Other Nonmajor Funds (Interim Loan Insurance)	Reimbursement of expenditures	(105,083)
Housing Finance Authority	Subsidy Prepayment Refunding Bonds - Debt Service	Reimbursement of expenditures	(76,686)
Housing Finance Authority	Other Nonmajor Funds (AHMSP Stage 7)	Reimbursement of expenditures	(850,056)
Housing Finance Authority	Other Nonmajor Funds AHMSP Law 124)	Reimbursement of expenditures	(552,307)
Housing Finance Authority	The Key for Your Home Program	Reimbursement of expenditures	(880)
Total			(172,951,799)
Total internal balances—net			$ (112,583,059)

Receivable by Fund	Payable by Fund	Purpose	Amount
Governmental fund:	**Governmental fund:**		
Other Nonmajor Funds (Special Obligation Refunding Bonds—Debt Service)	Other Nonmajor Funds (AHMSP Stage 7)	Advances	$ 8,951,808
Enterprise funds:	**Entreprise funds:**		
Housing Finance Authority	GDB Operating Fund	Demand deposits and accrued interest	$ 5,326,986
Development Fund	GDB Operating Fund	Demand deposits and accrued interest	40,723,996
Tourism Development Fund	GDB Operating Fund	Demand deposits and accrued interest	5,803,155
Public Finance Corporation	GDB Operating Fund	Demand deposits and accrued interest	1,066,241
Other Nonmajor (Education Assistance Corporation)	GDB Operating Fund	Demand deposits and accrued interest	2,190,595
Other Nonmajor (JMB Institute)	GDB Operating Fund	Demand deposits and accrued interest	212,593
Housing Finance Authority	GDB Operating Fund	Certificates of deposit and accrued interest	360,111,558
Public Finance Corporation	GDB Operating Fund	Certificates of deposit and accrued interes	303,066,048
Tourism Development Fund	GDB Operating Fund	Certificates of deposit and accrued interest	60,711,991
Housing Finance Authority	GDB Operating Fund	Guaranteed investment contracts and accrued interest	227,626,324
GDB Operating Fund	Housing Finance Authority	Bonds payable	110,213,038
GDB Operating Fund	Housing Finance Authority	Loans receivable and accrued interest	5,209,981
GDB Operating Fund	Tourism Development Fund	Loans receivable and accrued interest	264,200,949
GDB Operating Fund	Public Finance Corporation	Loans receivable and accrued interest	303,076,402
Total balance among enterprise funds eliminated			$ 1,689,539,857

The following table is a summary of interfund transfers for the year ended June 30, 2006:

Transfer Out	Transfer In	Transfer for	Amount
Governmental funds:	**Governmental funds:**		
Other Nonmajor Funds (AHMSP Stage 3)	The Key for You Home Program	Subsidy payments	$ 7,055,000
Affordable Housing Mortgage Subsidy Program—Stage 9	The Key for You Home Program	Subsidy payments	22,930,618
Affordable Housing Mortgage Subsidy Program—Stage 9	Other Nonmajor Funds (AHMSP Stage 10)	Subsidy payments	14,118,873
Affordable Housing Mortgage Subsidy Program—Stage 9	Other Nonmajor Funds (AHMSP Portfolio IV)	Subsidy payments	439,133
The Key for You Home Program	Affordable Housing Mortgage Subsidy Program—Stage 9	Subsidy payments	37,000
The Key for You Home Program	Other Nonmajor Funds (AHMSP Stage 10)	Subsidy payments	5,000
Enterprise funds:	**Governmental funds:**		
Housing Finance Authority	The Key for You Home Program	Subsidy payments	22,693,633
Housing Finance Authority	Other Nonmajor Funds (AHMSP Portfolio IIII)	Subsidy payments	26,799
Governmental funds:	**Enterprise funds:**		
Other Nonmajor Funds (AHMSP Portfolio IV)	Housing Finance Authority	Debt service payments	307,337
Other Nonmajor Funds (AHMSP Law 124)	Housing Finance Authority	Debt service payments	6,768
Other Nonmajor Funds (AHMSP Stage 10)	Housing Finance Authority	Debt service payments	3,519,603
Other Nonmajor Funds (AHMSP Stage 4)	Housing Finance Authority	Debt service payments	122,194
Affordable Housing Mortgage Subsidy Program—Stage 9	Housing Finance Authority	Debt service payments	6,562,647
The Key for You Home Program	Housing Finance Authority	Subsidy payments	1,500
Enterprise funds:	**Enterprise funds:**		
Housing Finance Authority	Housing Finance Authority	Residual Net Assets	15,408,561

21. SUBSEQUENT EVENTS

Housing Finance Authority

Sale of Mortgage Loans—On August 11, 2006 and October 10, 2006, the Housing Finance Authority sold mortgage loans with an outstanding principal balance of approximately $11.2 million. The net proceeds from the sale of such loans amounted to approximately $11.5 million, including accrued interest of $50,000, resulting in a gain of approximately $200,000.

Debt Issuance— On August 23, 2006, the Authority issued Mortgage-backed Certificates, 2006 Series A (the "Certificates") amounting to $165,643,717. The Certificates are collateralized by certain GNMA and FNMA certificates and mature at various dates through 2030. Proceeds from the issuance of the Certificates will be used for the defeasance of certain outstanding debt of the Authority, to fund escrow accounts and reserves for the payment of principal and interest on the Certificates, for the payment of related costs of issuance, bond defeasance costs and other expenses, and for the Authority' general business purposes.

Public Finance Corporation

Subsequent to June 30, 2006, the Public Finance Corporation disbursed approximately $303 million to pay the fiscal year 2007 debt service of its no-commitment debt on behalf of the Commonwealth. On October 4, 2006, the Department of the Treasury of the Commonwealth and the Bank, as administrators of the IIF, entered into a memorandum of understanding whereby the IIF agrees that the payment of principal of and interest on this advance will be paid from collections received by the IIF.