

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, 2011,
and Independent Auditors' Report

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

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Government Development Bank for Puerto Rico (the "Bank"), a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2011, 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, 2011, and the respective changes in financial position and respective cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 2 and 5 to the financial statements, loans to the Commonwealth of Puerto Rico and its agencies and instrumentalities amounted to approximately \$6.0 billion or 38.7% of the Bank's total assets as of June 30, 2011. These loans are expected to be collected from appropriations from, proceeds from bond issuances of, or revenues generated by the Commonwealth of Puerto Rico and/or its agencies and instrumentalities. Since 2000, the Commonwealth's recurring expenditures have exceeded its recurring revenues and its credit ratings have been lowered. In addition, many of the Commonwealth's agencies and instrumentalities have had losses from operations during the past years. The collectibility of these loans may be affected by budgetary constraints, the fiscal situation and the credit ratings of the Commonwealth of Puerto Rico and its agencies and instrumentalities, and their ability to generate sufficient funds from taxes, charges and/or bond issuances. Continuance of and/or significant negative changes in these factors may affect the ability of the Commonwealth and agencies and instrumentalities to repay their outstanding loan balances with the Bank and, accordingly, may have an adverse impact on the Bank's financial condition, liquidity, funding sources, and results of operations.

The management's discussion and analysis on pages 3 to 17 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of Government Development Bank for Puerto Rico's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

December 1, 2011

Stamp No. E15511
affixed to original.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2011

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, 2011. The information presented here should be read in conjunction with the basic financial statements, including the notes thereto.

1. FINANCIAL HIGHLIGHTS

- Total assets government wide at June 30, 2011 amounted to \$15,510 million for an increase of \$1,461 million or 10.4% from the \$14,049 million at June 30, 2010. Liabilities increased by 12.4% or \$1,421 million to \$12,926 million from \$11,505 million.
- Net assets government wide grew to \$2,584 million from \$2,544 million at June 30, 2010. The increase in net assets of \$40 million in fiscal year 2011 is composed of \$74 million from business-type activities offset by an excess of expenses and transfers over revenues of \$34 million from governmental activities. Net assets to total assets decreased to 16.7% at June 30, 2011 from 18.1% at June 30, 2010.
- The operating income of the GDB Operating Fund increased from \$67.5 million in 2010 to \$107.1 million or \$39.6 million in fiscal year 2011. This increase represented an improvement of 58.6% from the previous year.
- The Bank issued approximately \$3,503 million of Senior Notes consisting of \$1,448.7 million of Senior Notes 2010 Series A; \$151.3 million of Senior Notes 2010 Series B; \$1,086 million of Senior Notes 2010 Series C; \$96.4 million of Senior Notes 2010 Series D; \$70 million of Senior Notes 2011 Series A, and \$650 million of Senior Notes 2011 Series B. The Bank used the proceeds of these issuances mainly to repay previously issued notes with higher interest rates, increase the investment portfolio, and make loans to and purchase obligations of the Commonwealth of Puerto Rico (Commonwealth), its public corporations and municipalities.
- Interest income on loans in the GDB Operating Fund amounted to \$405.8 million in 2011, an increase of \$79.3 million over the prior year. The Bank collected approximately \$24.9 million in principal and \$139.1 million in interest on loans to the public sector from the general fund of the Commonwealth.
- Included within salaries and fringe benefits expense is approximately \$2.6 million related to an employees' voluntary termination plan provided under Act No. 70 of July 2, 2010.

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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.

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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, 2011 amounted to \$15,510 million and \$12,926 million, respectively, for net assets of \$2,584 million or 16.7% of total assets. Within assets, excluding the loans portfolio, cash and due from banks, and deposits placed with banks show the most significant growth of \$332 million and \$696 million, respectively, over fiscal year 2010 balances of \$15 million and \$45 million, respectively. Investments and investment contracts decreased by \$870 million or 14% when compared to prior year. The proportion of investments to total assets decreased to 34.5% in 2011 from 44.3% in 2010. In addition, federal funds sold decreased by approximately \$242 million or 73.2% when compared to the previous year.

Loan portfolio of \$8,396 million at June 30, 2011 shows an increase of 20.5% when compared to the prior year ending balance of \$6,966 million. Loans as a percentage of total assets grew 4.5% from 49.6% in fiscal year 2010 to 54.1% in fiscal year 2011.

The Bank's Operating Fund issued several note series during fiscal year 2011 for a net increase of \$2,125 million in this line item. The Bank has primarily used the proceeds from these notes to increase its investment portfolio, to make loans to the Commonwealth, its public corporations and municipalities, and to repay certain higher interest rate debt. On the other hand, the Bank decreased its funding from securities sold under agreements to repurchase by 8.3% over the 2010 balance.

Out of the \$2,584 million in net assets, \$2,151 million or 83.2% is unrestricted, \$301 million or 11.7% is restricted for use in housing programs, and the remaining \$132 million or 5.1% is invested in capital assets and restricted 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 \$164.2 million at June 30, 2011, before \$127.7 million in net balances due to business-type activities. Total liabilities amounted to \$72.1 million, for a net deficit of \$35.6 million. Net deficit has been broken down into the amounts restricted for affordable housing programs of \$50.7 million, and the unrestricted deficit of \$86.4 million, which means that the restriction on the use of available assets will not allow the Bank to satisfy its existing liabilities from those assets, and therefore that it will depend on future appropriations for the repayment of part of its obligations.

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Condensed financial information on assets, liabilities, and net assets of governmental activities as of June 30, 2011 and 2010 is shown below (amounts in thousands):

	June 30,		Change	
	2011	2010	Amount	Percent
Assets:				
Restricted:				
Cash and due from banks, and deposits placed with banks	\$ 72,295	\$ 7,527	\$ 64,768	860.5%
Investments and investment contracts	70,165	93,892	(23,727)	(25.3)%
Other assets	<u>21,723</u>	<u>29,494</u>	<u>(7,771)</u>	(26.3)%
Total assets before internal balances	164,183	130,913	33,270	25.4%
Internal balances	<u>(127,675)</u>	<u>(80,287)</u>	<u>(47,388)</u>	59.0%
Total assets	<u>36,508</u>	<u>50,626</u>	<u>(14,118)</u>	(27.9)%
Liabilities:				
Accounts payable and accrued liabilities	67,303	47,394	19,909	42.0%
Notes payable — due in more than one year	<u>4,811</u>	<u>4,811</u>	<u>-</u>	0.0%
Total liabilities	<u>72,114</u>	<u>52,205</u>	<u>19,909</u>	38.1%
Net deficit:				
Invested in capital assets	42	-	42	100.0%
Restricted for affordable housing programs	50,720	52,933	(2,213)	(4.2)%
Unrestricted deficit	<u>(86,368)</u>	<u>(54,512)</u>	<u>(31,856)</u>	58.4%
Total net deficit	<u>\$ (35,606)</u>	<u>\$ (1,579)</u>	<u>\$ (34,027)</u>	2,155.0%

Investments and investment contracts amounted to \$70.2 million and, together with cash and due from banks, and deposits placed with banks of \$72.3 million, account for the majority of the assets held by governmental activities. These assets are held to provide funds for the execution of the various affordable and other housing programs managed by the Puerto Rico Housing Finance Authority (the "Housing Finance Authority"). Other assets are composed principally of due from the HUD, Home, and ARRA federal programs. Accrued liabilities mainly consist of unpaid expenditures related to the ARRA and My New Home Program funds and of subsidies payable on various housing programs.

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Condensed financial information on expenses, program and general revenues, and changes in net assets of governmental activities for the years ended June 30, 2011 and 2010 is shown below (in thousands):

	<u>Year Ended June 30, 2011</u>		
	General Government	Housing Assistance Programs	Total
Expenses	<u>\$ 6,155</u>	<u>\$ 311,951</u>	<u>\$ 318,106</u>
Program revenues:			
Charges for services — financing and investment		4,690	4,690
Operating grants and contributions	<u>-</u>	<u>279,609</u>	<u>279,609</u>
Net expenses	<u>\$ (6,155)</u>	<u>\$ (27,652)</u>	(33,807)
Transfers — net			<u>(220)</u>
Change in net assets			(34,027)
Net deficiency — beginning of year			<u>(1,579)</u>
Net deficiency — end of year			<u>\$ (35,606)</u>

	<u>Year Ended June 30, 2010</u>		
	General Government	Housing Assistance Programs	Total
Expenses	<u>\$ 4,777</u>	<u>\$ 250,787</u>	<u>\$ 255,564</u>
Program revenues:			
Charges for services — financing and investment		4,743	4,743
Operating grants and contributions	<u>-</u>	<u>225,268</u>	<u>225,268</u>
Net expenses	<u>\$ (4,777)</u>	<u>\$ (20,776)</u>	(25,553)
Transfers — net			<u>(4,902)</u>
Change in net assets			(30,455)
Net assets — beginning of year			<u>28,876</u>
Net deficiency — end of year			<u>\$ (1,579)</u>

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4. GOVERNMENTAL FUND RESULTS

Operating grants and contributions increased by \$54 million when compared to the prior year. Operating grants and contributions increased from \$225 million in 2010 to \$279 million in 2011 mainly because this year the Housing Finance Authority earned \$96 million in ARRA funds as compared to \$87 million in 2010. In addition, the Housing Finance Authority received \$36.8 million from the Local Economic Stimulus Program to fund its Closing Costs Assistance Program as compares to \$10 million in 2010. In addition, during fiscal year 2011, the Housing Finance Authority earned \$16.4 million related to the Home program, which is administered by the Housing Finance Authority effective July 1, 2010.

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

HUD Programs — This fund accounts for the U.S. Housing Act Section 8 programs administered by the Housing Finance Authority under the authorization of the U.S. Department of Housing and Urban Development. Presently, the Housing Finance Authority operates three programs whereby low-income families receive directly or indirectly subsidies to pay for their rent. The housing vouchers program enables families to obtain rental housing in a neighborhood of their choice. The other programs are project-based subsidies whereby housing developers are given incentives to keep their properties available for certain markets. The expenditures of the HUD programs increased \$2 million from \$125 million in 2010 to \$127 million in 2011. The expenditures in the housing vouchers program increased \$1 million when compared to the previous year because additional vouchers were awarded.

ARRA Funds — This fund accounts for two federal programs established by ARRA. ARRA established a federal funding opportunity through two separate programs, the Section 1602, "Cash Assistance in Lieu of Tax Credits" program called the Tax Credit Exchange Program (TCEP) and Tax Credit Assistance Program (TCAP). Both programs make stimulus package funding available to multi-family rental projects that meet the requirements of the Low Income Housing Tax Credits program (LIHTC). TCEP allows state housing tax credit allocating agencies to exchange a portion of the housing tax credits for cash grants. The cash grants can then be used by the allocating agencies to make "subawards" to finance the construction or acquisition and rehabilitation of qualified low-income buildings. TCAP provides grant funding for capital investment in LIHTC projects through a formula-based allocation to each state. The purpose of the TCAP funding is to assist in filling the funding gap resulting from the decline in equity pricing. The revenues and expenditures of ARRA funds amounted to \$95.7 million in 2011 as compared to \$86.6 million in 2010.

Closing Costs Assistance Program — This fund accounts for the subsidy to eligible individuals or families for the purchase of an eligible principal residence. The subsidy consists of the reimbursement of origination and closing costs up to 5% of the selling price, which cannot exceed \$300,000, of the eligible principal residence. The Housing Finance Authority finances this program with transfers from its operating and administrative fund and from appropriations from the Commonwealth. During the year ended June 30, 2011, the program received \$36.8 million in appropriations from the Commonwealth. During the year ended June 30, 2011, subsidy expenditures amounted to \$35.9 million.

My New Home Program — This program provides closing costs assistance to eligible families for the purchase of a principal residence through reimbursements of origination and closing costs. During the year ended June 30, 2011, total subsidy expenditures amounted to \$31 million.

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At June 30, 2011, the Housing Finance Authority had various governmental funds in a deficit position. The Housing Finance Authority expects to cover these deficits through contributions from the Commonwealth. Refer to Note 22 to the basic financial statements for additional information on these funds.

5. BUSINESS-TYPE ACTIVITIES

Condensed financial information on assets, liabilities, and net assets as of June 30, 2011 and 2010, is presented below (amounts in thousands):

	June 30,		Change	
	2011	2010	Amount	Percent
Assets:				
Cash and due from banks	\$ 343,214	\$ 13,851	\$ 329,363	2,377.9%
Federal funds sold	88,850	331,000	(242,150)	(73.2)%
Deposits placed with banks	672,362	38,853	633,509	1,630.5%
Investments and investment contracts	5,278,429	6,124,707	(846,278)	(13.8)%
Loans receivable — net	8,395,959	6,966,384	1,429,575	20.5%
Interest and other receivables	235,085	178,245	56,840	31.9%
Real estate available for sale	128,568	207,792	(79,224)	(38.1)%
Other assets	132,151	41,072	91,079	221.8%
Due from other funds	127,675	80,287	47,388	59.0%
Capital assets	71,008	15,750	55,258	350.8%
Total assets	15,473,301	13,997,941	1,475,360	10.5%
Liabilities:				
Deposits:				
Demand	3,782,555	3,253,713	528,842	16.3%
Certificates of deposit	1,771,133	2,895,485	(1,124,352)	(38.8)%
Securities sold under agreements to repurchase	970,819	1,058,835	(88,016)	(8.3)%
Accrued interest payable	30,466	28,325	2,141	7.6%
Accounts payable, accrued liabilities, and other liabilities	109,255	98,038	11,217	11.4%
Certificates of indebtedness	4,300	11,800	(7,500)	(63.6)%
Bonds, notes, and mortgage-backed certificates payable:				
Due in one year	159,697	226,219	(66,522)	(29.4)%
Due in more than one year	6,025,328	3,879,986	2,145,342	55.3%
Total liabilities	12,853,553	11,452,401	1,401,152	12.2%
Net assets:				
Invested in capital assets	71,008	15,750	55,258	350.8%
Restricted for:				
Mortgage loan insurance	61,119	61,899	(780)	(1.3)%
Affordable housing programs	247,643	230,895	16,748	7.3%
Other housing programs	2,567	4,183	(1,616)	(38.6)%
Unrestricted	2,237,411	2,232,813	4,598	0.2%
Total net assets	\$ 2,619,748	\$ 2,545,540	\$ 74,208	2.9%

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Federal Funds Sold and Deposits Placed with Banks — The Bank decreased its federal funds sold by \$242 million, from \$331 million at June 30, 2010 to \$89 million at June 30, 2011. The Bank reduced the federal funds in favor of higher rate short term deposits placed with banks. Deposits placed with banks increased by \$633.5 million, from \$38.9 million to \$672.4 million. The increase is mostly attributed to a deposit of \$400 million with a financial institution for the refunding of a portion the GDB Senior Notes Series 2009 C and D on July 1, 2011.

Investments and Investment Contracts — Investments and investment contracts held in business-type activities amounted to \$5,278.4 million at June 30, 2011. This amount represents a decrease of \$846.3 million or 13.8% when compared to the prior year balance of \$6,124.7 million. The investment portfolio has consisted primarily of U.S. Treasury Notes, Treasury Bills and U.S. sponsored agency notes and mortgage-backed securities with very high credit ratings, reflecting the Bank's prudent and conservative investment policies. The majority of the Bank's investment portfolio is invested in AAA to A- rated securities. The investment portfolio comprised 34% of the total assets of the Bank's business-type activities at June 30, 2011, down by 10% as compared to 44% at the close of fiscal year 2010. Within the investment securities portfolio, \$1,503 million at June 30, 2011 and \$1,539 million at June 30, 2010, were restricted or pledged as collateral or payment source for specific borrowings.

Loans Receivable — Net loans receivable increased by \$1,429.6 million, from the \$6,966.4 million balance at June 30, 2010 to \$8,396 million at June 30, 2011. The increase primarily arises from the Bank's basic role of providing financial support to the Commonwealth's public works, particularly in times of economic hardship, such as the prevailing circumstances in the Island and world-wide. To support the governmental efforts of improving and stimulating the Island's economy, the Bank finances the development and construction of infrastructure, housing projects, and hotels.

Loans to municipalities had a net increase of \$325.3 million over the prior year balance. Some of these loans were possible with the improvement of the municipalities' debt margin capacity as a result of increases in the property and municipal sales taxes.

Private sector loans outstanding at June 30, 2011 and 2010 amounted to \$605 million and \$530 million, respectively, net of an allowance for loan losses and deferred origination fees of \$132.1 million and \$20 million at June 30, 2011, and \$85 million and \$9.5 million at June 30, 2010, respectively. Private sector loans mainly include loan facilities for the housing and tourism sectors through some component units of the Bank. Refer to Note 5 for further information on loans receivable and allowance for loan losses.

Real Estate Available for Sale — Real estate available for sale includes several properties received in fiscal year 2009 in lieu of payment of a loan whose principal balance and accrued interest receivable amounted to \$144.2 million at December 30, 2008. The current appraised value of these properties amounts to \$78 million. Additional properties are being negotiated with the parties involved to satisfy the deficiency.

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In the meantime, the Bank has recorded a receivable for this difference as permitted by the agreement with the transferor. The Office of Management and Budget of the Commonwealth ("OMB") will disburse approximately \$7.5 million before December 31, 2011 to cover a portion of this difference. In addition, the OMB has committed to include in the Commonwealth general fund budget an amount of approximately \$3.8 million plus interest at the rate of 7% for the next fifteen years to assist the agencies involved in the transaction in repaying the accounts receivable of the Bank. The proposed appropriation will be subject to the approval of the Legislature of the Commonwealth of Puerto Rico.

Capital Assets — Capital assets, net of accumulated depreciation and amortization, amounted to \$71 million at June 30, 2011, an increase of \$55 million from the prior year. Additions to capital assets during the year ended June 30, 2011 aggregated to \$1.3 million principally in the software line item. Depreciation and amortization of \$2.5 million was charged to operations during fiscal year 2011. In addition, property from real estate available for sale of approximately \$56.4 was transferred to capital assets as of June 30, 2011. Refer to Note 8 to the basic financial statements for additional information on capital assets.

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 decrease of \$595 million, from \$6,149 million at June 30, 2010 to \$5,554 million at June 30, 2011. Deposits constitute approximately 43% and 54% of total liabilities at June 30, 2011 and 2010, respectively. Maturing deposits have been offset by the issuance of medium term notes and other borrowed funds.

Securities Sold under Agreement to Repurchase — Securities sold under agreements to repurchase decreased by \$88 million or 8.3% from \$1,058.8 million to \$970.8 million at June 30, 2011.

Other Borrowed Funds — The Bank issued several note series during fiscal year 2011, which explains the net growth of \$2,078.8 million or 51% over prior year balance of \$4,106.2 million. Most of the notes issued during fiscal year 2011 consist of term notes maturing on various dates from August 1, 2011 to August 1, 2025. Most of such notes have early redemption options. Interest rates on such notes range from 2% to 5.75%. Certain notes, upon compliance with certain requirements of the U.S. Internal Revenue Code, will receive a subsidy payment from the federal government equal to 35% of the amount of each interest payment of these notes. The Bank used the proceeds from these obligations for general operational purposes that include, among others, the substitution of higher cost debt, the increase of its investment portfolio and the funding of loans. Responding to market conditions, the Bank has increased its issuance of medium term notes and significantly reduced its commercial paper borrowings, which has lengthened the average maturity of its liabilities. Refer to Note 12 to the basic financial statements for additional information on borrowed funds.

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Condensed financial information on expenses, program revenues, and changes in net assets for business-type activities for the years ended June 30, 2011 and 2010 is presented below (in thousands):

Activity	Year Ended June 30, 2011			
	Expenses	Program revenues		Net revenues (expenses)
		Charges for services		
		Fees, commissions, and others	Financing and investment	
GDB Operating Fund	\$ 409,653	\$ 14,084	\$ 486,860	\$ 91,291
Housing Finance Authority	93,504	13,321	89,326	9,143
Tourism Development Fund	50,125	5,191	28,042	(16,892)
Public Finance Corporation	4		1	(3)
Capital Fund	37	35	1	(1)
Development Fund	10,947	-	(1,434)	(12,381)
Other nonmajor	110	2,381	5	2,276
Total	\$ 564,380	\$ 35,012	\$ 602,801	73,433
Special item —Contribution from Puerto Rico Infrastructure Financing Authority				555
Transfers from governmental activities				220
Change in net assets				74,208
Net assets — beginning of year				2,545,540
Net assets — end of year				\$ 2,619,748

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Activity	Year Ended June 30, 2010				
	Expenses	Program revenues			Net revenues (expenses)
		Charges for services		Operating grants and contributions	
		Fees, commissions, and other	Financing and investment		
GDB Operating Fund	\$ 342,854	\$ 23,518	\$ 382,737	\$ -	\$ 63,401
Housing Finance Authority	96,153	11,114	104,413	34,000	53,374
Tourism Development Fund	28,410	1,968	9,717	15,000	(1,725)
Public Finance Corporation	4,681		4,679		(2)
Capital Fund	68	1	5,807		5,740
Development Fund	3,555	3	622		(2,930)
Other nonmajor	140	-	3	-	(137)
Total	\$ 475,861	\$ 36,604	\$ 507,978	\$ 49,000	117,721
Special item — Contribution from Puerto Rico Infrastructure Financing Authority					1,110
Transfers from governmental activities					4,902
Change in net assets					123,733
Net assets — beginning of year					2,421,807
Net assets — end of year					\$ 2,545,540

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 \$486.9 million from its loan and investment portfolios, and \$14.1 million in other charges for services, including its fiscal agency function. These revenues covered \$409.7 million in expenses for a change in net assets from GDB Operating Fund of \$91.7 million, surpassing the change in net assets of any other activity.

The Housing Finance Authority's activities were the second largest contributor to the change in net assets with a \$9.4 million increase. Operating losses of other major component units for fiscal year 2011 were as follows: Tourism Development Fund with \$16.9 million and Development Fund with \$12.4 million.

Enterprise Funds — Following is a brief discussion of the most significant changes in the Bank's enterprise funds, not previously discussed. Our main focus will be on 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.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS AS OF AND FOR THE YEAR ENDED JUNE 30, 2011

GDB Operating Fund — Total assets of the GDB Operating Fund amounted to \$14,547 million at June 30, 2011, compared to \$13,209 million at June 30, 2010. This represents an increase of \$1,338 million, which was sustained by the net increase in liabilities of \$1,247 million and the change in net assets of \$92 million. As already discussed, the GDB Operating Fund issued debt widening its assets base and obtaining more liquidity to assist governmental entities in times of economic distress. Investments decreased by \$829 million and loans to the public sector increased by \$1,355 million. Accrued interest receivable increased from \$128 million at June 30, 2010 to \$234 million at June 30, 2011, mainly because of increases in interest rates on loans due to a pricing initiative during the first semester of last year and a net increase of \$1.4 billion on loans. During the year, a portion of principal and interest on loans, aggregating to approximately \$164 million was collected from the general fund of the Commonwealth of Puerto Rico. Refer to Note 5 to the basic financial statements for additional information on loan receivables and allowances on loan losses.

Operating income of the GDB Operating Fund experienced an increment from \$67.5 million in fiscal year 2010 to \$107.1 million in fiscal year 2011, or an increase of \$39.6 million, which represents a 59% increase. Change in net assets had a significant increase from \$64.4 million in fiscal year 2010 to \$91.7 million in fiscal year 2011. Following is a discussion of the various components of the change in net assets of the GDB Operating Fund, compared to the prior year:

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

Net investment income, the difference between investment income and interest expense, increased \$26.5 million or 28%, from \$95.7 million in 2010 to \$122.2 million in 2011. Most of the increase results from the loan portfolio, which shows an increase of \$79 million or 24% when compared to the prior year results. This increase is directly related to the increase on loans of \$1,395 million from \$6,803 million in fiscal year 2010 to \$8,198 million in fiscal year 2011. Change in fair value of investments contributed to the increase with a gain of \$33.8 million. That is \$17 million more than the gain of \$16.8 million of fiscal year 2010. Interest income from investments increased \$7.8 million or 19.8% mainly because of concentration of our investment portfolio in U.S. Government and U.S. agencies securities where interest rates increased. Interest expense increased by \$77.6 million, or 27.1%, mainly as a result of a net increase of \$2,125 million in the notes line item offset by decreases of \$776 million in the deposits and \$88 million in the securities sold under agreements to repurchase line items.

(b) *Provision for Losses on Loans*

The experience with the public sector loan portfolio, even in periods of economic distress such as the present, provides continued comfort to management. After an analysis performed, management believes that there is no need for further provisions, instead, there was a credit to the provision for loan losses of \$5.6 million leaving the allowance for loan losses with a balance of \$4 million at June 30, 2011. Management believes that there is no need for an allowance for possible losses on guarantees and letters of credit to public sector entities.

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(c) Noninterest Income

Noninterest income decreased to \$14.1 million in fiscal year 2011 from \$23.5 million in fiscal year 2010, or \$9.4 million. Fiscal agency fees constitute the main component of noninterest income. There was an intense activity of bond issuances of public sector entities during fiscal year 2010 when compared to fiscal year 2011. The fiscal agency fees decreased from \$17.2 million in fiscal year 2010 to \$5.7 million in fiscal year 2011, representing a decrease of 67%.

(d) Noninterest Expenses

Total noninterest expenses showed a decrease of \$17 million from \$51.7 million in fiscal year 2010 to \$34.7 million in fiscal year 2011. Decrease is mainly because of the following three major items in fiscal year 2010: (1) write downs to real estate available for sale of approximately \$11.9 million, (2) voluntary and involuntary terminations costs of \$3.5 million and (3) a \$2.2 million termination fee linked to the adjustable refunding bonds. These 2010 items were presented within salaries and fringe benefits and other expense line items.

Housing Finance Authority — Net assets of the Housing Finance Authority increased by \$9.4 million from \$635.2 million at June 30, 2010 to \$644.6 million at June 30, 2011 as a result of decreases in total assets of \$19.5 million and in liabilities of \$28.9 million. The decrease in total assets is mainly due to the following:

- Cash decreased from \$31.6 million at June 30, 2010 to \$9.7 million at June 30, 2011 or a \$21.9 million decrease. The decrease was the result of the following factors: reduction of \$12 million on the Home Purchase Stimulus Program due to payment of second mortgages to financial institutions, reduction of \$8 million used for bonds principal payment on Mortgage Trust III, and reduction of \$4 million due to origination of multifamily and single-family loans offset by an increase of \$3 million of My New Home Program.
- Investments and deposits placed with banks decreased from \$1,265 million at June 30, 2010 to \$1,199 million at June 30, 2011 or a \$66 million decrease. This decrease was principally the result of investment redemptions to originate construction and single-family loans.

