Government Development Bank for Puerto Rico

(A Component Unit of the Commonwealth of Puerto Rico)

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

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Independent Auditors' Report

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Government Development Bank for Puerto Rico (the "Bank"), a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2005, which collectively comprise the Bank's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the respective financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of Government Development Bank for Puerto Rico, as of June 30, 2005, and the respective changes in financial position and respective cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 34 to 43 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of Bank's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP
San Juan, Puerto Rico

October 28, 2005

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

(1) Financial Highlights

- Assets and liabilities of the Bank at June 30, 2005 amounted to $10,366 million and $8,404 million, respectively, for net assets of $1,962 million or 19% of total assets.

- Net assets decreased during the fiscal year by $354 million. The decrease in net assets comprises $343 million from business-type activities due to a $500 million contribution to the Special Communities Irrevocable Trust Fund, and $11 million from governmental activities.

(2) Overview of the Financial Statements

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

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

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

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

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

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

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

(3) Government-wide Financial Analysis

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

Governmental Activities

Total assets of governmental activities amounted to $238 million at June 30, 2005, before $100 million in net balances due to business-type activities. Total liabilities amounted to $131.1 million, for net assets of $6.3 million or 4.6% of total assets net of balances due to business-type activities. Net assets have been broken down into the amounts restricted for debt service of $53.4 million and for affordable housing programs of $41.6 million, and the unrestricted deficit of $88.7 million, which means that the restrictions existing on the use of available assets will not allow the Bank to satisfy its existing liabilities from those assets, and therefore that it will depend on future appropriations for the repayment of all its obligations.

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

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

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

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

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

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

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

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

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

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

Business-Type Activities

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

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

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

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

Investments and Investment Contracts

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

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

Loans Receivable

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

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

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

Capital Assets

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

Deposits

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

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

Commercial Paper

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

Other Borrowed Funds

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

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

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

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

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

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

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

(4) Analysis of Fund Financial Statements

Governmental Funds

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

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

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

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

Affordable Housing Mortgage Subsidy Program (Stage 9)

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

Subsidy Prepayment Refunding Bonds – Debt Service

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

New Secure Housing Program

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

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

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

The Key for Your Home Program

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

HUD Programs

This fund accounts for the subsidy to low- and moderate-income families for the rental of decent and safe dwellings under the U.S. Housing Act Section 8 programs. This fund had total revenues and expenditures of $113.8 each for the year ended June 30, 2005. In fiscal year 2004, this fund also had $113.8 in revenues and expenditures, which were presented in the Housing Finance Authority enterprise fund.

Enterprise Funds

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

GDB Operating Fund

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

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

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

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

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

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

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

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

(c) Noninterest Income

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

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

(d) Noninterest Expenses

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

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

(e) Nonoperating Expenses

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

Puerto Rico Housing Finance Authority

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

Capital Fund

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

Development Fund

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

Tourism Development Fund

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

Public Finance Corporation

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

(5) Debt

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

(6) Contacting the Bank's Financial Management

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

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

See accompanying notes to basic financial statements.

Statement of Activities

For the year ended June 30, 2005

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

See accompanying notes to basic financial statements.

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

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

See accompanying notes to basic financial statements.

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

For the year ended June 30, 2005

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

See accompanying notes to basic financial statements.

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds to the Statement of Activities

For the year ended June 30, 2005

Amounts reported for governmental activities in the statement of net assets are different because:	
Net change in fund balances - total governmental funds	$ (52,031,094)
Repayment of the principal of long-term debt consumes the current financial resources of governmental funds.	36,105,000
Some expenses in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.	(682,987)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	5,639,185
Governmental funds report the effect of issuance costs when debt is first issued, whereas these costs are deferred and amortized in the statement of activities. This amount is the amortization for the year.	(16,500)
Change in net assets of governmental activities	$ (10,986,396)

See accompanying notes to basic financial statements

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

See accompanying notes to basic financial statements.

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

See accompanying notes to basic financial statements.

Statement of Revenues, Expenses, and Changes in Net Assets - Enterprise Funds
For the year ended June 30, 2005

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

See accompanying notes to basic financial statements.

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

See accompanying notes to basic financial statements

(Continued)

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

See accompanying notes to basic financial statements

(Continued)

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

See accompanying notes to basic financial statements

(Continued)

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

See accompanying notes to basic financial statements.

(Concluded)

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

Pursuant to Act No. 82 of June 16, 2002, which amended the Bank's enabling legislation, the Bank is authorized to transfer annually to the General Fund of the Commonwealth (the "General Fund") up to 10% of its net income or $10 million, whichever is greater. Management of the Bank has defined net income as the increase in unrestricted net assets of business-type activities for a fiscal year. The Bank's board of directors approved such definition. No transfer was made during the year ended June 30, 2005 because the Bank's business-type activities had a decrease in net assets.

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

The Housing Finance Authority (formerly known as the Puerto Rico Housing Finance Corporation) was created in 1977 to provide public and private housing developers with interim and permanent financing through mortgage loans for the construction, improvement, operation, and maintenance of rental housing for low- and moderate-income families. The Housing Finance Authority also issues bonds and notes, the proceeds of which are deposited in separate trusts and generally invested in federally insured mortgage loans on properties located in Puerto Rico and purchased by low- and moderate-income families. The Housing Finance Authority is authorized by the U.S. Department of Housing and Urban Development to administer the U.S. Housing Act Section 8 program in Puerto Rico and to act as an approved mortgagor, both for multifamily rental units and for single-family homes. In addition, it is an authorized issuer of Government National Mortgage Association ("GNMA") mortgage-backed securities, and is Puerto Rico's State Credit Agency for the Low-Income Housing Tax Credit Program under Section 42 of the U.S. Internal Revenue Code.

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

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

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

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

The Capital Fund was created in 1992 to expand the investment options available to the Bank and to administer, separately from the Bank's general investment operations, an equity investments process through professional equity investment managers. In January 2002, the Bank's board of directors authorized an increase in the capitalization of the Capital Fund of up to 10% of the net assets of the Bank, as well as the adoption of a new investment strategy, which included the hiring of two additional portfolio managers to diversify the Capital Fund investments in the equity markets. As of June 30, 2005, management, with the consent of the Bank's board of directors, deemed convenient to defer its implementation.

Other nonmajor funds include the JMB Institute and the Education Assistance Corporation. The JMB Institute was created in 2002 to complement the Bank's mission of promoting economic development by providing specialized training on the theory and practice of public finances and economics to talented young professionals in order to attract them to join the public service. The Education Assistance Corporation was created in 1981 to administer the Stafford Loan Program in Puerto Rico and guarantee the payment of student loans granted by financial institutions in Puerto Rico under certain terms and restrictions. The operations of this fund were transferred to a guarantee agency designated by the U.S. Department of Education. The Education Assistance Corporation is currently inactive.

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

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

Government-wide and Fund Financial Statements

Government-wide Financial Statements—The statement of net assets and the statement of activities report information on all nonfiduciary activities of the Bank. The effect of interfund balances has been removed from the government-wide statement of net assets, except for the residual amounts due between governmental and business-type activities. Interfund charges for services among functions of the government-wide statement of activities have not been eliminated. The Bank's activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services. Following is a description of the Bank's government-wide financial statements.

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

- Invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

- Restricted net assets result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on use that are imposed by management, but such constraints may be removed or modified.

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

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

Separate financial statements are provided for governmental funds and enterprise funds. Major individual governmental funds are reported as separate columns in the fund financial statements, with nonmajor funds being combined into a single column. Fund balances at the beginning of the year are restated to reflect changes in major fund definition. In the case of enterprise funds, each individual blended component unit of the Bank with the exception of JMB Institute and Education Assistance Corporation, which have been grouped as other nonmajor funds, has been reported as a separate major fund in the fund financial statements. In the case of the Housing Finance Authority, all of its activities not classified and reported as governmental funds have been reported as an enterprise fund.

Measurement Focus, Basis of Accounting, and Financial Statements Presentation

Government-Wide Financial 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, 2005, has been reported only in the government-wide financial statements.
- Interest on general long-term obligations is generally recognized when paid.
- Debt service principal expenditures and claims and judgments are recorded only when payment is due.

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

- ***Affordable Housing Mortgage Subsidy Program (Stages 8 and 9)***—These special revenue funds are used to account for the proceeds of specific revenue sources under Stages 8 and 9 of the Affordable Housing Mortgage Subsidy Program ("AHMSP") that are legally restricted to expenditures to promote the origination of mortgage loans by financial institutions in the private sector to low- and moderate-income families. These funds are two of the ten funds that are under the AHMSP of the Authority.
- ***Subsidy Prepayment Refunding Bonds*** – Debt Service (Act No. 115 Rent Subsidy Fund)—This debt service fund is used to account for the Commonwealth appropriations to provide for the payment of principal and interest of certain bonds that were originally issued by a former mortgage subsidy program.
- ***New Secure Housing Program (Nuevo Hogar Seguro)***—This special revenue fund is used to account for federal and local resources directed to plan, coordinate, and develop the construction of new housing as a replacement for those destroyed by Hurricane Georges in 1998 and to attend the housing needs of those families living in flood zone areas.

- ***HUD Programs***—This special revenue fund accounts for the subsidy to low- and moderate-income families for the rental of decent and safe dwellings under the U.S. Housing Act Section 8 programs.

- ***The Key for Your Home Program***— It was created to provide subsidy to low- and moderate-income families with costs directly related to the purchase and rehabilitation of housing units.

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

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

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

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

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

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

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

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

Securities Purchased Under Agreements to Resell—The Bank enters into purchases of securities under agreements to resell. The amounts advanced under these agreements generally represent short-term loans and are reflected as an asset. The securities underlying these agreements are usually held by the broker or his/her agency, with whom the agreement is transacted.

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

Loans Receivable and Allowance for Loan Losses—Loans in the enterprise funds are presented at the outstanding unpaid principal balance reduced by any charge-offs and the allowance for loan losses. The accrual of interest on loans to the private sector ceases when loans become past due over six months. For loans to public sector entities, the accrual of interest ceases when management determines that all of the following characteristics are present: (a) a loan is six months past due; (b) it has no current source of repayment; (c) is not covered by a formal commitment from the Commonwealth; and (d) has no designated collateral or such collateral is insufficient. Once a loan is placed in nonaccrual status, all accrued interest receivable is reversed from interest income. Interest income on nonaccrual loans is thereafter recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when management has adequate evidence to believe that the loans will be performing as contracted.

The allowance for loan losses is established through provisions recorded in the fund financial statements. The allowance is based on management's evaluation of the risk characteristics of the loan including such factors as the nature of individual credits outstanding, past loss experience, known and inherent risks in the portfolios, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and general economic conditions. Loan charge-offs are recorded against the allowance when management believes that the collectibility of the principal is unlikely. Recoveries of amounts previously charged off are credited to the respective allowance.

Loans considered to be impaired are generally reduced to the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent, by allocating a portion of the allowance for loan losses to such loans. If these allocations cause increases to the allowance for loan losses, such increase is reported as provision for loan losses.

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

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

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

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

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

Allowance for Losses on Guarantees and Letters of Credit—Management of the Bank periodically evaluates the credit risk inherent in the guarantees and letters of credit on the same basis as loans are evaluated. The Bank charges as expense the amount required to cover estimated losses by establishing a specific allowance component for guarantees and letters of credit relating to loans in default, determined on the basis of the estimated future net cash outlays in connection with the related guarantees, and a general component for the risk inherent in the other guarantees and letters of credit outstanding, established as a percentage of the principal amount of the underlying loans based on the Bank's loss experience on financial guarantees and management's best judgment.

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

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

Pursuant to the legislation under which the Tourism Development Fund was created, the Executive Director of the Tourism Development Fund is required to certify each year to the Director of the OMB the amount, if any, that is necessary to reimburse the Tourism Development Fund for disbursements made in the previous year, in connection with obligations guaranteed in excess of fees and charges collected on such guarantees. This legislation currently does not expressly provide for the reimbursement of losses incurred by the Tourism Development Fund on loans made directly by the Tourism Development Fund. The Tourism Development Fund is in the process of submitting an amendment to this legislation to provide for the reimbursement of such losses. The Director of the OMB has to include the amount subject to reimbursement in the General Budget of the Commonwealth for the following fiscal year for the Legislature's consideration and approval. The Legislature is not obligated to authorize such appropriations. During the year ended June 30, 2003, the Tourism Development Fund initiated a process with the OMB to claim certain reimbursements for disbursements made under the guarantees in excess of fees and charges corresponding to fiscal years 2000 and 2002. Reimbursements from the Commonwealth, if any, are recorded as a receivable to the extent appropriated by the Commonwealth's Legislature. No reimbursements were received nor appropriated in 2005.

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

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

Allowance for losses on Mortgage Loan Insurance—The allowance for losses on mortgage loan insurance is based on management's evaluation of potential losses on insurance claims after considering economic conditions, market value of related property and other pertinent factors. Such amounts are, in the opinion of management, adequate to cover estimated future normal mortgage loan insurance losses. Actual losses for mortgage loan insurance are charged and recoveries, if any, are credited to the allowance for losses on mortgage loan insurance.

Capital Assets—Capital assets, which include premises and equipment, are stated at cost less accumulated depreciation and amortization, and are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the Bank as assets which have a cost of $500 or more at the date of acquisition and have an expected useful life from three or more years. Depreciation is charged to operations and included within other noninterest expense, and is computed on the straight-line basis over the estimated useful lives of the depreciable assets, which have been determined to be from three to five years for furniture and equipment. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Costs of maintenance and repairs, which do not improve or extend the lives of the respective assets, are charged to expense as incurred.

Estimated useful lives are as follows:

Building	40 years
Leasehold improvements	5-10 years
Information systems	3 years
Office furniture and equipment	5 years
Vehicles	5 years

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

Compensated Absences—The employees of the Bank are granted 30 days of vacation and 18 days of sick leave annually. Vacation and sick leave may be accumulated up to a maximum of 72 and 90 days, respectively. In the event of employee resignation, an employee is reimbursed for accumulated vacation and sick leave days up to the maximum allowed. The enterprise fund financial statements and the government-wide financial statements present the cost of accumulated vacation and sick leave as a liability. There are no employees paid by governmental funds.

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

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

No-Commitment Debt—The Housing Finance Authority has issued notes and bonds in connection with the financing of low- and moderate-income housing projects. Certain of the obligations issued by the Housing Finance Authority are considered no-commitment debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements. The Bank, the Housing Finance Authority and the Commonwealth, except for the assets held in trust and earnings thereon, are not liable directly or indirectly for the payment of such obligations.

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

From time to time, the Public Finance Corporation issues bonds, the proceeds of which are used to purchase from the GDB Operating Fund promissory notes of the Commonwealth, and of certain of its instrumentalities, and public corporations. The bonds are limited obligations of the Public Finance Corporation and, except to the extent payable from bond proceeds and investments thereon, are payable solely from the pledge and assignment of amounts due on the notes. Principal and interest on the notes are payable solely from legislative appropriations to be made pursuant to acts approved by the Legislature of the Commonwealth. The underlying notes represent debt of the issuing instrumentalities. The bonds are considered no-commitment debt, and therefore neither the bonds nor the notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The table presented below discloses the level of custodial credit risk assumed by the Bank at June 30, 2005. Custodial credit risk is the risk that in the event of a financial institution failure, the Bank's deposits may not be returned to it. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. The Bank does not have a formal policy for custodial credit risk for cash accounts opened with commercial banks outside Puerto Rico. These accounts are opened only with well-capitalized financial institutions.

The Bank's policies for deposits placed with banks, federal funds sold and securities purchased under agreements to resell establish maximum exposure limits for each institution based on the institution's capital, financial condition and credit rating assigned by nationally recognized rating agencies. Deposits placed with banks mature as follows: $50 million on July 1, 2005, $290 million on July 5, 2005, and $14.7 million on September 6, 2005. Federal funds sold mature overnight and no collateral is required. As of June 30, 2005, $1,766,872,576 of the depository bank balance of $1,779,371,273 was uninsured and uncollateralized as follows:

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

Reconciliation to the government-wide statement of net assets:

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

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

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

4. INVESTMENTS

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

- U.S. government and agencies obligations
- Certificates and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth of Puerto Rico, its agencies, municipalities, public corporations, and instrumentalities
- Federal funds sold
- Securities purchased under agreements to resell
- World Bank securities
- Mortgage- and asset-backed securities
- Corporate debt, including investment contracts
- External investment pools
- Stock of corporations created under the laws of the United States of America or the Commonwealth
- Options, futures, and interest-rate swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products which qualify under any of the foregoing investment categories
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's

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

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

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

The following table summarizes the type and maturities of investments held by the Bank at June 30, 2005. Investments by type in any one issuer representing 5% or more of total investments of either the Bank or its blended component units have been separately disclosed. Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment Type	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	Total
U.S. Treasury bills	$ 19,874,031	$ 46,670	$ -	$ -	$ 19,920,701
U.S. Treasury notes	13,222,219				13,222,219
U.S. sponsored agencies notes:					
Federal Home Loan Bank (FHLB)	5,968,140	283,502,775	74,325,000		363,795,915
Federal Home Loan Mortgage Corporation (FHLMC)	99,824,308				99,824,308
Federal Farm Credit Bank (FFCB)	10,905,400				10,905,400
Federal National Mortgage Association (FNMA)	7,955,100				7,955,100
Mortgage and asset -backed securities:					
Government National Mortgage Association (GNMA)		241,578	14,711,754	513,571,319	528,524,651
FNMA	152,943	1,521,580	4,948,744	39,424,120	46,047,387
FHLMC	176,104	1,497,092	14,923,576	27,024,461	43,621,233
Other	567,803	6,817,070	1,502,988	1,207,134	10,094,995
Corporate debt:					
Popular NA		60,335,850			60,335,850
Other		7,883,780			7,883,780
External investment pools - Fixed-income securities	35,338,215				35,338,215
Nonparticipating investment contracts:					
CDC Funding	285,640,596			52,418,767	338,059,363
American International Group		94,878,246		134,093,370	228,971,616
Banco Popular de Puerto Rico	200,000,000			18,873,208	218,873,208
Other	68,021	41,068,000	675	153,677,012	194,813,708
Total investments	$ 679,692,880	$ 497,792,641	$ 110,412,737	$ 940,289,391	2,228,187,649
External investment pools - Equity securities:					
Russell 1000 Growth Common Trust Fund					69,868,435
Guayacan Private Equity Fund					15,605,219
Venture Capital Fund, Inc.					1,755,376
Other					105,034
Equity securities					647,463
Total					$ 2,316,169,176
Reconciliation to the government-wide statement of net assets					
Unrestricted investments					$ 940,308,261
Restricted investments					1,375,860,915
Total					$ 2,316,169,176

Investments in fixed-income external investment pools had an average maturity of less than 60 days; accordingly, they were presented as investments with maturity of less than one year. These investments include $24,907,692 invested with the Puerto Rico Government Investment Trust Fund, a government sponsored pool, which is administered by the Bank. This pool is subject to regulatory oversight by the Commissioner of Financial Institutions of Puerto Rico.

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

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

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

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

As of June 30, 2005, the Bank had pledged investments and investment contracts to secure the following:

Payment of principal and interest on obligations issued by a blended component unit	$1,194,082,870
Securities sold under agreements to repurchase	199,034,000
Certificates of indebtedness	62,484,000

5. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

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

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

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

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

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

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

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

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

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

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

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

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

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

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

7. CAPITAL ASSETS

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

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

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

8. DEPOSITS

Deposits consist predominantly of interest-bearing demand accounts, special government deposit accounts, and time deposits from the Commonwealth, its agencies, instrumentalities, and municipalities. Interest expense on these deposits amounted to approximately $113.3 million in 2005.

9. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

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

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

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

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

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

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

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

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

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

All sales of investments under agreements to repurchase are for fixed terms. In investing the proceeds of securities sold under agreements to repurchase, the Bank's policy is for the term to maturity of investments to be on or before the maturity of the related repurchase agreements. At June 30, 2005, securities sold under agreements to repurchase mature as follows: $339,034,000 within one month and $100 million within five years.

10. COMMERCIAL PAPER

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

The following information corresponds to commercial paper:

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

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

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

11. CERTIFICATES OF INDEBTEDNESS

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

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

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

Year Ending June 30

2006	$ 213,671,703
2007	47,384,000
Total	$ 261,055,703

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

12. BONDS AND NOTES PAYABLE AND OTHER LIABILITIES

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

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

	Beginning Balance	Issuances, Net	Reductions	Ending Balance	Due within One Year
Business-type activities:					
GDB Operating Fund—Adjustable Refunding Bonds	$ 267,000,000	$ -	$ -	$267,000,000	$ -
Housing Finance Authority: Mortgage Trust III	1,164,063,874	-	(43,540,000)	1,120,523,874	43,310,000
Revenue bonds:					
Collateralized Mortgage Revenue Bonds	71,950,000	-	(10,275,000)	61,675,000	1,338,000
Single Family Mortgage Revenue Bonds – Portfolio I	43,375,000	-	(715,000)	42,660,000	830,000
Single Family Mortgage Revenue Bonds – Portfolio II (net of elimination of $4,535,000)	9,350,000	-	(2,850,000)	6,500,000	-
Single Family Mortgage Revenue Bonds – Portfolio III	20,720,000	-	(16,690,000)	4,030,000	22,000
Single Family Mortgage Revenue Bonds, Stage IX-2002	350,000,000	-	(2,675,000)	347,325,000	5,475,000
Single Family Mortgage Revenue Bonds – Portfolio IV	60,564,000	-	(901,000)	59,663,000	957,000
Mortgage Trust IV: Collateralized mortgage obligations	50,750,895	-	(25,651,180)	25,099,715	-
Homeownership Mortgage Revenue Bonds 2000	89,000,000	-	(13,180,000)	75,820,000	1,423,000
Homeownership Mortgage Revenue Bonds 2001	89,330,000	-	(9,500,000)	79,830,000	1,015,000
Homeownership Mortgage Revenue Bonds 2003	43,575,000	-	(8,060,000)	35,515,000	655,000
Total revenue bonds	828,614,895	-	(90,497,180)	738,117,715	11,715,000
Subtotal Housing Finance Authority	1,992,678,769	-	(134,037,180)	1,858,641,589	55,025,000
Notes payable (operations and administration)	16,675,261	14,376,165	(9,576,796)	21,474,630	21,474,630
Less unaccreted discount	676,259,589	-	(36,435,286)	639,824,303	850,132
Total Housing Finance Authority	1,333,094,441	14,376,165	(107,178,690)	1,240,291,916	75,649,498
Tourism Development Fund notes payable to GDB	259,862,049	-	(26,175,173)	233,686,876	79,437,481
Total	1,859,956,490	14,376,165	(133,353,863)	1,740,978,792	155,086,979
Less intrafund elimination	(355,495,382)	(2,176,165)	18,145,916	(339,525,631)	(83,371,820)
Total business-type activities	$ 1,504,461,108	$12,200,000	$(115,207,947)	$ 1,401,453,161	$ 71,715,159

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

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

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

Governmental Activities

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

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

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

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

During June 2004, the Public Finance Corporation advance refunded a portion of certain of its outstanding Commonwealth appropriation bonds issued in 2001 under Act No. 164 of December 17, 2001. The Housing Finance Authority recognizes a mirror effect of this advance refunding by the Public Finance Corporation in its own notes payable in proportion to the portion of the Housing Finance Authority's notes payable included in the Public Finance Corporation refunding. The aggregate debt service requirements of the refunding and unrefunded notes will be funded with annual appropriations from the Commonwealth. At June 30, 2005, approximately $4.1 million of the notes refunded during June 2004 remain outstanding and are considered defeased.

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

Business-Type Activities

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

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

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

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

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

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

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

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

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

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

13. RESTRICTED NET ASSETS—MORTGAGE LOAN INSURANCE FUND

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

14. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

In the normal course of business, the Bank is party to transactions involving financial instruments with off-balance-sheet risk, to meet the financing needs of its customers. These financial instruments include commitments to extend credit and contributions, standby letters of credit, and financial guarantees. These instruments involve, to varying degrees, elements of credit risk in excess of amounts recognized in the accompanying statement of net assets and fund balance sheets. These off-balance-sheet risks are managed and monitored in manners similar to those used for on-balance-sheet risks. The Bank's exposures to credit loss for lending commitments, financial guarantees, and letters of credit are represented by the contractual amount of those transactions.

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

At June 30, 2005, the off-balance-sheet risks consisted of the following (in thousands):

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

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

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

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

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

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

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

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

15. DERIVATIVE INSTRUMENTS

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

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

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

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

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

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

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

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

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

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

16. RETIREMENT SYSTEM

Defined Benefit Pension Plan

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

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

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

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

Commonwealth Legislation requires employees to contribute 5.775% of the first $550 of their monthly gross salary and 8.275% for the excess over $550 of monthly gross salary. The Bank is required by the same statute to contribute 9.275% of each participant's gross salary.

Defined Contribution Plan

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

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

The Bank is required by Act No. 305 to contribute 9.275% of each participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan.

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

Total employee contributions for the defined benefit pension plan and the defined contribution plan during the year ended June 30, 2005 amounted to approximately $1,656,000. The Bank's contributions during the years ended June 30, 2005, 2004, and 2003 amounted to approximately $1,864,000, $1,733,000, and $1,810,000, respectively. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the Retirement System itself.

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

17. COMMITMENTS AND CONTINGENCIES

Lease Commitments

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

Cooperative Development Investment Fund

On August 18, 2002, the Legislature of the Commonwealth approved Law No. 198, which creates the Cooperative Development Investment Fund. The purpose of this fund is to promote the development of cooperative entities. This fund will be capitalized through contributions to be provided by the Bank up to $25 million to be matched by cooperative entities. As of June 30, 2005, the Bank has contributed $7.2 million to the Cooperative Development Investment Fund, $2.2 million of which were contributed during the year ended June 30, 2005.

Other Risks Related to Mortgage Loans Servicing and Insurance Activities

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

Custodial Activities of Enterprise Funds

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

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

Loan Sales and Securitization Activities

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

Mortgage Loan Servicing Activities

The Housing Finance Authority acts as servicer for a number of mortgage loans owned by other investors. The servicing is generally subcontracted to a third party. As of June 30, 2005, the principal balance of the mortgage loans serviced for others is as follows:

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

Litigation

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

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

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

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

The Public Finance Corporation has issued approximately $6 billion of Commonwealth appropriation bonds (the "Bonds") maturing at various dates through 2031. The proceeds of the Bonds, except for approximately $1.7 billion, have been used to provide the necessary funds to purchase from the Bank separate promissory notes of the Department of the Treasury of the Commonwealth, and certain of its instrumentalities and public corporations (the "Notes"). The $1.7 billion referred to above were used to refund a portion of certain bonds issued by the Public Finance Corporation (also no-commitment debt) between fiscal years 1995 and 2000. The outstanding balance of the Bonds at June 30, 2005 amounted to approximately $4.3 billion.

The Bonds are limited obligations of the Public Finance Corporation and, except to the extent payable from bond proceeds and investment earnings thereon, will be payable solely from a pledge and assignment of amounts due under the Notes. Principal and interest on the Notes are payable solely from legislative appropriations to be made pursuant to acts approved by the Legislature of the Commonwealth. These acts provide that the Commonwealth shall honor the payment of principal and interest on the Notes, and that the Director of the OMB shall include in the budget of the Commonwealth submitted to the Legislature the amounts necessary to pay the principal and interest on the Notes. The underlying promissory notes represent debt of the issuing instrumentalities (all part of the Commonwealth or its component units), and, for purposes of the Public Finance Corporation, the Bonds are considered no-commitment debt. Neither the Bonds nor the Notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements.

Certain bonds of the Housing Finance Authority are considered no-commitment debt as more fully described in Note 1. At June 30, 2005, there were restricted assets held in trust by others, outstanding obligations, fund balances, and excess of fund expenses over revenues, net of transfers (all of which are excluded from the accompanying basic financial statements), as indicated below (unaudited):

Restricted assets	$ 85,192,092
Restricted liabilities (no commitment debt)	65,955,083
Restricted fund balance	$ 19,237,009
Excess of fund expenses over revenues	$ 895,724

In addition, the Housing Finance Authority issued in December 2003 $663 million in Capital Fund Program Bonds Series 2003 to lend the proceeds thereof to the Public Housing Administration (PHA), a governmental instrumentality of the Commonwealth. PHA utilized such funds for improvements to various public housing projects in the Commonwealth. The Capital Fund Program Bonds Series 2003 are limited obligations of the Housing Finance Authority, which will be paid solely from an annual allocation of public housing capital funds when received from the U.S. Department of Housing and Urban Development and other funds available under the bonds indenture, accordingly, these bonds are considered no-commitment debt and are not presented in the accompanying basic financial statements. The outstanding balance of these bonds amounted to $667 million at June 30, 2005.

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

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

19. CONTRIBUTION TO THE SPECIAL COMMUNITIES IRREVOCABLE TRUST FUND

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

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

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

20. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

- Short-term financial instruments, such as federal funds sold, cash and due from banks, repurchase and resale agreements, certificates of deposit, commercial paper, and accrued interest receivable and payable have been valued at the carrying amounts reflected in the statement of net assets, as these are reasonable estimates of fair value given the relatively short period of time between origination of the instruments and their expected realization.

- Financial instruments that are primarily traded in secondary markets, such as most investments, were valued using either market price, pricing models, or quoted market prices of financial instruments with similar characteristics.

- Financial instruments that are not generally traded, such as certificates of deposit and investment contracts, and bonds issued with fixed interest rates, were fair valued, for the most part, using the present values of estimated future cash flows at the appropriate discount rates. Bonds issued with interest rates floating within certain ranges were fair valued at their outstanding principal balance. The fair value of liabilities with no defined maturities, such as demand deposits, was reported as the amounts payable upon demand.

- Loans to the public sector were valued according to the type of contractual interest rate. Loans to the public sector with interest rates floating within certain ranges were fair valued at their outstanding principal balance. Loans to the public sector with fixed interest rates were fair valued assuming that such loans were packaged and sold in the secondary market. The discount rates utilized were based on the rating of the Commonwealth and the market where the instruments would be sold and were adjusted for various other factors, including issuance costs. For delinquent public sector loans, the fair value was assumed to be equal to the carrying value, as historically the Bank has collected such amounts.

- Loans and commitments to extend credit to the private sector are mostly industrial development, tourism development, and low-cost housing development projects. For these types of loans and commitments, there is no secondary market, and the actual future cash flows may vary significantly as compared to the cash flows projected under the agreements, due to the degree of risk. Accordingly, management has opted not to disclose the fair value to these financial instruments, as such information may not be estimated with reasonable precision.

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

- Interest rate swaps used in asset-liability management were valued using estimated market prices, based on discounted future cash flows.

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

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

21. INTERFUND BALANCES AND TRANSFERS

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

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

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

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

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

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