INDEPENDENT AUDITORS' REPORT

American International Plaza, Suite 1100
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San Juan, PR 00918-1819

The Board of Directors
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, 2002, 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 opinions on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Government Development Bank for Puerto Rico, as of June 30, 2002, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in note 2 to the basic financial statements, the Bank has implemented Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus – an amendment of GASB Statements No. 21 and No. 34*, Statement No. 38, *Certain Financial Statement Note Disclosures*, and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, as of July 1, 2001.

The management's discussion and analysis on pages 26 through 38 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

January 13, 2003

Stamp No. 1828098 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

This section presents a narrative overview and analysis of the financial performance of Government Development Bank for Puerto Rico (the Bank) for the year ended June 30, 2002. 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, 2002 amounted to $8,676 million and $6,674 million, respectively, for net assets of $2,002 million or 23% of total assets.
- Change in net assets from the prior year amounted to $217.7 million. This amount is net of a $35.3 million of contribution to the Commonwealth of Puerto Rico (the Commonwealth) pursuant to Act No. 82 of June 16, 2002 which allows the Bank beginning with fiscal year 2001 to transfer annually to the General Fund of the Commonwealth $10 million or 10% of "net income" (which the Bank has interpreted to mean change in net assets), whichever is greater. The $35.3 million include the contributions corresponding to fiscal years 2001-2002 and 2000-2001. The increase in net assets comprises $149.1 million from business-type activities and $68.6 million from governmental activities.
- The accompanying basic financial statements include the balances and transactions of the former Puerto Rico Housing Bank and Finance Agency (Housing Bank) which was merged into the Puerto Rico Housing Finance Authority (Housing Finance Authority or the Authority), a blended component unit of the Bank, effective February 11, 2002 and pursuant to Act No. 103 of August 11, 2001. The merger was accounted for retroactively to the beginning of the fiscal year. Act No. 103 also provided for the transfer to the Budgetary Fund of the Commonwealth the excess of assets over liabilities of the former Housing Bank at the date of the merger. At June 30, 2002, the statement of net assets includes a balance of $197.7 million included in due to the Commonwealth in connection with this obligation to the Budgetary Fund.
- With the approval of Act No. 164 of December 17, 2001, during the year the Bank sold in the capital markets approximately $2.4 billion of loans to agencies and public corporations of the Commonwealth that previously had no designated source of repayment.

(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 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 spendable resources, as well as balances of spendable 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 each of the Bank's blended component units, which are considered major funds of the Bank.

Notes to the 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, 2002 amounted to $8,676 million and $6,674 million, respectively, for net assets of $2,002 million or 23% of total assets. From the $2,002 million in net assets, $1,570 million or 78% are unrestricted, $350 million or 17.5% are restricted for use in affordable housing programs, and of the remaining 4.5%, part is invested in capital assets and the rest is 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

Fiscal year 2002 is the first year in which government-wide financial statements are presented for the Bank and, as a result, comparative analysis at the government-wide level has been omitted for governmental activities. As prior year data becomes available in future years, our discussion will include a comparative analysis of governmental activities.

Statement of Net Assets

Total assets of governmental activities amounted to $313.3 million at June 30, 2002, net of $51.9 million in net balances due to business-type activities. Total liabilities amounted to $274.1 million, for net assets of $39.1 million or 12.5% of total assets. Net assets have been broken down into the amounts restricted for debt service of $45.9 million and for affordable housing programs of $184.6 million, and the unrestricted deficit of $191.4 million, which means that the restrictions existing on the use of available assets will impede the Bank from satisfying its existing liabilities from those assets, and therefore that it will depend on future appropriations for the repayment of all its obligations.

Condensed assets, liabilities, and net assets for governmental activities are shown below (amounts in thousands):

ASSETS	
Due from Commonwealth of Puerto Rico	$ 4,929
Due from municipalities and other component units of the Commonwealth of Puerto Rico	1,477
Due from federal government	14,968
Restricted:	
Cash and deposits placed with banks	14,971
Investments and investment contracts	319,135
Loans receivable, net	4,990
Other assets	4,686
Internal balances	(51,876)
Total assets	313,280
LIABILITIES AND NET ASSETS	
Due to Commonwealth of Puerto Rico	75,000
Accounts payable and accrued liabilities	7,776
Note payable	10,029
Bonds payable	181,340
Total liabilities	274,145
Net assets:	
Restricted for debt service	45,868
Restricted for affordable housing programs	184,636
Unrestricted deficit	(191,369)
Total net assets	$ 39,135

Investments and investment contracts amounted to $319.1 million and account for the majority of assets held by governmental activities. These investments, together with deposits placed with banks of $11.5 million, are held to provide the funds necessary for the execution of the various affordable housing programs managed by the Housing Finance Authority and, to some extent, for debt service. Governmental activities also have balances due from the Commonwealth and the federal government of $4.9 million and $15 million, respectively, that are related to the reimbursement of eligible expenses incurred in the New Secure Housing Program.

Liabilities include $75 million due to the Commonwealth related to the transfer of residual net asset of the former Housing Bank's governmental activities, as set forth by Act No. 103 of August 11, 2001. This obligation to the Commonwealth emerged with the Department of the Treasury's assumption, effective on August 11, 2001, of a line of credit that the former Housing Bank had with the Bank. The line of credit with the Bank had been taken to provide funds for the Affordable Housing Mortgage Subsidy Programs and was to be repaid with Commonwealth appropriations. The net assets freed-up with the Department of the Treasury's assumption of the debt were to be transferred to the Commonwealth, pursuant to the Act, with the rest of the unrestricted net assets of the former Housing Bank.

The most significant liabilities of governmental activities are the bonds and notes payable amounting to $181.3 million and $10 million at June 30, 2002, respectively. During the year, principal payments to service the bonds amounted to $45.1 million. The only increase in bonds and notes payable during the year is related to the issuance of the $10 million note payable.

Statement of Activities

Condensed expenses, program revenues, and change in net assets governmental funds are shown below (amounts in thousands):

	General Government	Housing Subsidy Program	Interest on long-term debt	Total
Expenses	$ 1,961	43,922	25,496	71,379
Program revenues:				
Charges for services – financing and investment	—	23,806	—	23,806
Operating grants and contributions	—	49,954	6,956	56,910
Capital grants and contributions	—	54,748	—	54,748
Net (expenses) revenues	$ (1,961)	84,586	(18,540)	64,085
General revenues:				
Unrestricted income and transfers				$ 4,515
Change in net assets				68,600
Net assets (deficit), beginning of year				(29,465)
Net assets, end of year				$ 39,135

Total expenses of governmental activities amounted to $71.4 million for the year ended June 30, 2002. Total expenses include $43.9 million used in Affordable Housing Subsidy Programs and $25.5 million for interest on long-term obligations. Revenues from financing and investing activities provided $23.8 million to be used for the benefit of the housing subsidy programs, while grants of $111.7 million were received for housing subsidy programs and to service long-term debt. General revenues and transfers from business-type activities provided an additional $4.5 million to cover expenses, for a change in net assets for the year of $68.6 million.

Business-type Activities

Prior year balances used for the comparative analysis of business-type activities include balances and transactions of the former Housing Bank as if the entity had been merged with the Housing Finance Authority since the beginning of the prior fiscal period. To arrive at the pro forma figures used in the analysis, elimination entries were made to eliminate the effect of balances between the former Housing Bank and both the Authority and the Bank as of June 30, 2001.

Statement of Net Assets

Total assets of business-type activities decreased by $253.4 million or 3%, from $8.62 billion as of June 30, 2001 to $8.36 billion as of June 30, 2002. The decrease is primarily the net result of the repayment of the Bank's commercial paper with the proceeds from the sale or repayment of loans and an increase in certificates of deposit.

Condensed assets, liabilities and net assets are presented below (amounts in thousands):

	JUNE 30		CHANGE	
ASSETS	**2002**	**2001**	**AMOUNT**	**%**
Cash and due from banks	$ 24,901	115,465	(90,564)	(78.4)
Federal funds and securities purchased under agreement to resell	1,546,500	1,605,540	(59,040)	(3.7)
Deposits placed with banks	568,089	12,813	555,276	4333.7
Investments and investment contracts	3,744,119	2,219,194	1,524,925	68.7
Loans receivable, net	2,259,263	3,938,254	(1,678,991)	(42.6)
Interest and other receivables	99,790	282,798	(183,008)	(64.7)
Due from CRIM and Commonwealth of Puerto Rico	—	208,594	(208,594)	(100.0)
Tax lien receivables	—	96,864	(96,864)	(100.0)
Other assets	68,627	137,095	(68,468)	(49.9)
Internal balances	51,876	—	51,876	100.0
Total assets	$ 8,363,165	8,616,617	(253,452)	(2.9)
LIABILITIES AND NET ASSETS				
Deposits:				
Demand	$ 2,070,536	2,385,039	(314,503)	(13.2)
Certificates of deposit	1,797,573	758,590	1,038,983	137.0
Certificates of indebtedness	294,591	253,216	41,375	16.3
Securities sold under agreement to repurchase	170,000	250,000	(80,000)	(32.0)
Commercial paper	398,746	1,250,430	(851,684)	(68.1)
Accrued interest payable	15,382	29,347	(13,965)	(47.6)
Due to Commonwealth of Puerto Rico	162,027	142,356	19,671	13.8
Accounts payable and accrued liabilities	185,279	279,272	(93,993)	(33.7)
Bonds payable	1,305,978	1,454,410	(148,432)	(10.2)
Total liabilities	6,400,112	6,802,660	(402,548)	(5.9)
Net assets	1,963,053	1,813,957	149,096	8.2
Total liabilities and net assets	$ 8,363,165	8,616,617	(253,452)	(2.9)

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

Federal funds and securities purchased under agreements to resell decreased by $59 million or 3.7%, from $1,606 million at June 30, 2001 to $1,547 million at June 30, 2002. These were maintained at relatively the same level as in 2001. Deposits placed with banks amounted to $568.1 million at June 30, 2002 compared to $12.8 million at June 30, 2001.

Investments and Investment Contracts

Investments and investment contracts held in business-type activities amounted to $3,744.1 million at June 30, 2002. This amount represents a $1,525 million increase or 69% when compared to prior year figures. The growth in the investment portfolio was funded with proceeds from the sale of a substantial portion of the Bank's portfolio of loans to public corporations and agencies of the Commonwealth, in connection with the approval of Act No. 164 of December 17, 2001 (Act No. 164). The bulk of the increase in the investment portfolio was in U.S. government and agencies securities.

The investment portfolio comprised 44.8% of the total assets of the Bank's business-type activities at June 30, 2002, compared to 25.8% at the close of fiscal year 2001. Within the investment securities portfolio, $1,173.7 million at June 30, 2002 and $1,314.3 million at June 30, 2001 were restricted or pledged as collateral or payment source for specific borrowings.

Loans Receivable

Net loans receivable of $2.26 billion accounted for 27% of total assets of business-type activities at June 30, 2002 (46% in 2001). The applicable variance is the primarily net result of approximately $4,213 million of principal collected and sale of loans net of loans originated of $2,490 million.

Act No. 164 authorized the Department of the Treasury, the Bank, and the Puerto Rico Office of Management and Budget to restructure and refinance certain public entities' debt with the Bank in the aggregate amount of approximately $2.4 billion that previously had no designated source of repayment. Act No. 164 provides that the Legislature will assign annual payments not to exceed $225 million from the General Fund of the Commonwealth for the repayment of these obligations, allowing the Bank to sell them in the capital markets. During the period from December 2001 to June 2002 and pursuant to Act No. 164, the Puerto Rico Public Finance Corporation, a blended component unit of the Bank, issued various bond series aggregating to $2.4 billion that were used primarily to buy such debt from the Bank.

Most of the public sector loans have alternative payment sources available through appropriations in the Commonwealth's 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, the Bank is no longer allowed to originate loans without a specific source of repayment being identified beforehand. Act No. 164 provides, however, for the Bank to originate new loans up to $100 million without a specific source of repayment with 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, 2002 and 2001 amounted to $270.4 million and $227.7 million, respectively, net of allowance for loan losses of $24.3 million and $24 million, respectively. The increase responds to an aggressive campaign by the Housing Finance Authority to originate construction and permanent mortgage loans. Loan originations by the Authority during the year amounted to $80.9 million and collections were $33.5 million. Activity in the private sector loans of the Bank was not significant and was mainly limited to the normal amortization of the portfolio.

Due from CRIM and Commonwealth and Tax Lien Receivables

Balances due from Municipal Revenue Collection Center (CRIM, by its Spanish acronym) and the Commonwealth of $208.6 million and tax lien receivables of $96.9 million at June 30, 2001 were collected during the year with the cancellation of the tax debts transaction as described in detail in note 13 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, and instrumentalities.

Demand deposits decreased by 13.2% from $2,385 million at June 30, 2001 to $2,071 million at June 30, 2002. This decrease, which is due to the regular movement of funds by depositors, was more than offset by an increase in certificates of deposit.

Certificates of deposit increased by 137% from $758.6 million at June 30, 2001 to $1,798 million at June 30, 2002. The increase arose primarily because while there was no Tax Revenue Anticipation Notes (TRANs) issued by the Commonwealth in fiscal year 2001, there was an $800 million TRANs issue in fiscal year 2002. This issue required deposits for debt service into a redemption fund at the Bank, as paying agent, during the last quarter of the fiscal year prior to their maturity in July 2002.

Commercial Paper

Commercial paper decreased by 68% from $1,250 million at June 30, 2001 to $398.7 million at June 30, 2002. The decrease is directly related to the sale of loans triggered by Act No. 164. Since a portion of the loans sold was funded with commercial paper, the Bank used a corresponding portion of the proceeds to liquidate related commercial paper outstanding. The reduction in the commercial paper took place during the final quarter of the year, consistent with the commercial paper program's available window of 90 days from the cancellation of the loans to the repayment of the commercial paper.

Other Borrowed Funds

Bonds payable decreased by 10% from $1,454 million at June 30, 2001 to $1,306 million at June 30, 2002. In addition to the effect of the scheduled repayment of debt, this decrease is primarily the net effect of the cancellation during the year of the tax debts collateralized bonds of the Public Finance Corporation, which had an outstanding balance at June 30, 2001 of $206.5 million, and the issuance of $127 million of Home Mortgage Revenue Bonds by the Housing Finance Authority in August of 2001. For additional information on the activity of bonds payable during the year, see note 13 to the basic financial statements.

Statement of Activities

Condensed expenses, program revenues, and change in net assets for business-type activities are presented below (amounts in thousands):

		PROGRAM REVENUES			
		CHARGES FOR SERVICES			
Activity	Expenses	Fees, commissions, and other	Financing and investment	Operating grants and contributions	Net revenues (expenses)
GDB Operating Fund	$ 260,470	17,986	345,977	—	103,493
Housing Finance Authority	205,955	12,520	134,499	112,708	53,772
Tourism Development Fund	9,258	7,244	3,114	50,000	51,100
Public Finance Corporation	37,332	—	7,944	32,056	2,668
Capital Fund	70	—	(20,310)	—	(20,380)
Development Fund	42	—	502	—	460
Totals	$ 513,127	37,750	471,726	194,764	191,113
Contributions to others					(38,262)
Transfers to governmental activities					(3,755)
Change in net assets					149,096
Net assets, beginning of year					1,813,957
Net assets, end of year					$ 1,963,053

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 $346 million from its loan and investment portfolios and generated $18 million in fees, primarily fiscal agency fees and fees charged on deposit accounts. These revenues covered $260 million in expenses for net revenues from GDB Operating Fund of $103 million, surpassing the net revenues of any other activity and contributing to the $149 million in change in net assets for the year.

Housing Finance Authority activities were the second largest contributor to the change in net assets with net revenues of $53.8 million. The net revenues of $51.1 million from the Tourism Development Fund are mostly the result of a $50 million transfer from the GDB Operating Fund, which is included within the expenses of the GDB Operating Fund. Likewise, the net revenues of Public Finance Corporation are net of a $32 million transfer, also included within expenses of the GDB Operating Fund.

Contributions to others include $35.3 million transferred to the Commonwealth pursuant to Act No. 82 of June 16, 2002. This amount includes $10 million of the contribution for fiscal year 2001 and $25.3 million of the contribution for fiscal year 2002.

(4) ANALYSIS OF FUND FINANCIAL STATEMENTS

Governmental Funds

Through its blended component unit, the Housing Finance Authority, the Bank has four major governmental funds: two special revenue funds and two debt service funds. Following, we provide an analysis of the financial position and changes in financial position of these major governmental funds.

Affordable Housing Mortgage Subsidy Program – Stage 7

At June 30, 2002, the fund's assets consisted substantially of its investment in collateralized mortgage obligations of $92 million, which provided investment earnings during the year of $5.4 million. The fund's only liability is a balance due to the Commonwealth of $75 million. At June 30, 2001, the fund had a line of credit with the Bank for $75 million that was assumed by the Department of the Treasury of the Commonwealth on August 11, 2001, freeing the fund of this obligation. However, the fund was then obligated to the Commonwealth for $75 million pursuant to Act No. 103 of August 11, 2001, as amended, which provides for the transfer to the Budgetary Fund of the Commonwealth of the excess of assets over liabilities of Housing Bank upon its merger with the Authority.

Fund balance increased by $16.3 million from $757,333 at June 30, 2001 to $17.1 million at June 30, 2002. The primary source of the increase was the proceeds from a note payable of $10,029,360 issued in connection with the refinancing of public debt permitted by Act No. 164. Also, Commonwealth appropriations of $16.8 million received and interest on investments of $5.4 million were more than sufficient to cover a net loss in fair value of investments of $1.7 million, subsidy payments of $6.4 million and interest expense of $8.5 million.

Subsidy Prepayment Refunding Bonds – Debt Service Fund

During the year ended June 30, 2002, Commonwealth appropriations of $32.2 million and investment earnings of $2.1 million were just sufficient to cover debt service expenditures of $34.2 million, for a net change in fund balance of approximately $31,000.

At June 30, 2002, total bonds outstanding payable through this debt service fund amounted to approximately $141.7 million.

New Secure Housing Program Fund

During the year ended June 30, 2002, 212 eligible families occupied completed dwellings. Currently, the program continues to develop two additional housing projects and has plans for 12 additional projects in the future.

During the year, the program recognized revenue from federal and Commonwealth appropriations of approximately $27.4 million and $7.1 million, respectively. Construction costs paid during the year amounted to approximately $18.9 million, and are included in payments for housing subsidy program in the accompanying statement of revenues, expenditures, and changes in fund balances.

Fund deficit decreased by $13.9 million during the year, from a deficit of $31 million at June 30, 2001 to a deficit of $17.1 million at June 30, 2002. The deficit at June 30, 2002 is primarily due to the deferral of federal grant revenue in the amount of $16.4 million for which eligibility requirements have not been met.

Special Obligation Refunding Bonds – Debt Service Fund

During the year, the fund received Commonwealth appropriations of approximately $6.9 million and earned interest amounting to approximately $2.2 million on certain program loans. Debt service requirements for the year amounted to approximately $13.3 million, $12.5 million and $781,000 in principal and interest, respectively. Debt service for the year included the final repayment of the Puerto Rico Urban Renewal and Housing Corporation bonds. The net change in fund balance was a reduction of $6.3 million or 26% from prior year.

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 $6,823 million at June 30, 2002, compared to $6,748 at June 30, 2001, an increase of 1%. Even though there was only a small increase in total assets, the mix varied considerably from the prior year. The sale of loans in connection with Act No. 164 accounts for the large decrease in loans receivable of $1,725 million or 46%. The investment of the proceeds from such sale of loans explains the corresponding increases in investments and investment contracts of $1,824 million or 99% from the prior year and in deposits placed with banks of $495 million from none in 2001.

Total liabilities increased slightly by $7.1 million to $5,448 million at June 30, 2002. However, as with assets, the mix varied considerably. Deposits increased from $3,447 million or 25.9% to $4,338 million at June 30, 2002. The main reason for the increase relates to debt service deposit requirements of the Commonwealth for the $800 million 2002 TRANs issue, as there were no TRANs issued in 2001. Commercial paper decreased 68% or $851.7 million from $1,250 million outstanding at June 30, 2001. With the sale of loans pursuant to Act No. 164, the portion of the commercial paper outstanding linked to such loans was subsequently repaid, causing the reduction.

Change in net assets of the GDB Operating Fund decreased 77.6% from $291.5 million in 2001 to $65.2 million in 2002. There are various factors for this decrease, but the most significant is the fact that change in net assets in 2001 includes $191.6 million of a transfer from the Capital Fund of the proceeds from the sale of a substantial portion of the Capital Fund's investments. The purpose of this transaction was to reduce the Bank's exposure to the equity markets, which had become increasingly volatile.

Following we discuss the various components of the change in net assets of the GDB Operating Fund, compared with 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, increased $52.1 million from $128.1 million in 2001 to $180.2 million in 2002. Interest expense dropped by 37.7% from $227.5 million to $141.8 million, interest income decreased by 9.4% from $355.6 million to $322 million. Various factors that helped attenuate the effect of falling interest rates on interest income are worth mentioning. Of particular significance is the window of opportunity provided to the GDB Operating Fund by Act No. 164 to restructure, retroactively to July 1, 2001, the portfolio of nonperforming public sector loans identified by the act. The restructuring entailed the capitalization of accrued interest at June 30, 2001 and an adjustment to the interest rate on the loans to a fixed 8% until their securitization. The difference between the rates of the original loans and the rate of the refinancing over an increased principal amount produced approximately $30.8 million of additional interest income until the first related bond issue in December 2001. Also, from the proceeds of the first bonds issued, the GDB Operating Fund collected $10.6 million of nonaccrual interest of certain loan bonded out. Additionally, but unrelated to the restructuring of Act No. 164, in January 2002 the Public Buildings Authority issued bonds to refinance certain debt with the GDB Operating Fund. This transaction resulted in the recognition by the GDB Operating Fund of $10.3 million in nonaccrual interest. Finally, another factor contributing to fend off the effect of falling rates was the additional spread gained by the GDB Operating Fund from the triggering of a 5% floor on the interest rate charged on public sector loans. This floor permitted the GDB Operating Fund to gain spread as the cost of funds decreased to unprecedented levels.

Change in fair value of investments decreased from $26.5 million in 2001 to $23.9 million in 2002. As seen in the prior year, declining interest rates during 2002 yielded valuation gains in the investment portfolio.

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

After a revaluation of the private sector loan portfolio of the GDB Operating Fund, an adjustment of $1.5 million was recorded to reduce the allowance thereof. The GDB Operating Fund recorded no provision in 2001.

No provision for losses on guarantees and letters of credit was recorded in 2002. The $12.7 million provision recorded in 2001 is related to a guarantee of certain obligations of the Puerto Rico Maritime Shipping Authority, a component unit of the Commonwealth, which were disbursed by the GDB Operating Fund in the first semester of 2002.

(c) Noninterest Income

Fiscal agency fees income increased 75% from $6 million in 2001 to $10.4 million in 2002. The predominantly low interest rates of the bond market together with its characteristic stability in contrast to the fluctuations and uncertainties of the stock market resulted in a receptive market and allowed Commonwealth issuers to take advantage of historically low rates and, consequently, the year 2002 turned out to be a record year in terms of bond issues managed by the GDB Operating Fund.

(d) Noninterest Expenses

Salaries and fringe benefits remained flat when compared to the prior year, with an increase of only 0.6%. The effect of yearly salary increases was partially offset by stringent controls on overtime pay and the absence in 2002 of expenses related to the early retirement window of calendar year 2000, of which part of the cost was recorded in the first semester of fiscal year 2001. The reduction of $1.1 million or 10.7% in professional services reflects management's continued effort to streamline the use of external consulting services.

(e) Contributions to Others

Contributions to others in 2002 include a contribution to the General Fund of the Commonwealth of $35.3 million pursuant to Act No. 82 of June 16, 2002. This amount is comprised of $10 million corresponding to fiscal year 2001 and $25.3 million corresponding to fiscal year 2002. Contributions to others also include grants of $2 million in both 2001 and 2002, to partially cover operational expenses of the Puerto Rico Art Museum.

(f) Gain on Early Extinguishment of Debt

As a result of the Public Finance Corporation realizing during the year a loss on early extinguishment of debt of $19.6 million from the cancellation of the tax debt collateralized bonds, the GDB Operating Fund amortized by this amount the deferred revenue that was recorded for the $132 million received from the Commonwealth to help the GDB Operating Fund and the Public Finance Corporation cover the losses related to this transaction.

Housing Finance Authority

Total net assets of the Authority's enterprise funds increased by $50 million or 15% during the year. This change resulted from a net interest income after provision for loan losses of $29.2 million during the year, noninterest income of $150 million, and noninterest expenses of $125.5 million, including $112.3 million in federal assistance program both, received and expensed, a $22.4 million positive change in the fair value of investments, and a net transfer to governmental funds of $3.8 million.

Capital Fund

The Capital Fund's total net assets decreased $20.4 million or 26% during the year as a result of a decrease in the fair value of its investments of $20.9 million, which is presented as change in fair value of investments in the statement of revenues, expenses, and changes in net assets – enterprise funds. This decrease is related to the general downturn in the equity markets during the year and compares favorably to a loss of almost $50 million in 2001.

Development Fund

Net assets of the Development Fund increased by $460,000 or 1.5% during the year. Operating revenues of $502,000 were almost evenly split between interest income and a net increase in the fair value of investments. Interest income decreased 69% when compared to the prior year due to the general decrease in market interest rates. Similarly, the net increase in fair value of investments was 64% less than what was reported in fiscal year 2001, reflecting the general downturn in the economy and receding equity markets.

Tourism Development Fund

Net assets of the Tourism Development Fund increased by $51.1 million or 99% from 2001 mainly due to a transfer of $50 million received from the GDB Operating Fund to increase the Tourism Development Fund's guaranteeing capacity. At June 30, 2002, outstanding guarantees and letter of credit commitments of the Tourism Development Fund stood at $606.2 million.

Public Finance Corporation

The net assets of the Public Finance Corporation increased $2.7 million or 130% during the year. This change in net assets, however, does not capture the significance of transactions that affected the Public Finance Corporation in fiscal year 2002. Total assets decreased by 93% or $224.1 million as a result of the cancellation of the tax debts collateralized bonds with the proceeds from the collection of amounts due from CRIM and the Commonwealth. The cancellation of the bonds resulted in a loss on early extinguishment of debt of $19.6 million. This loss, together with an operating loss of $9.8 million, was offset by a net transfer of $32 million received from the GDB Operating Fund.

(5) DEBT

Total bonds and notes outstanding at year-end amounted to $1,497.3 million of which $1,220.3 million are payable from restricted assets held by the Housing Finance Authority. The only new bond issue during the year was the issuance of $127 million in Homeownership Mortgage Revenue Bonds by the Authority to fund its Affordable Housing Mortgage Subsidy Program. Repayments and other reductions in debt outstanding aggregated $351.1 million, including $206.5 million from the cancellation of the tax debts collateralized bonds of the Public Finance Corporation. See note 13 to the basic financial statements for additional information on debt activities during the year.

(6) NEXT YEAR'S EVENTS

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 Perpetual Trust, (Special Communities Trust) an entity created to finance a variety of initiatives, primarily housing and infrastructure, directed to improve the living conditions of disadvantaged communities across the island.

In addition, the Legislature approved 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. The 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 10 fiscal years starting with the budget of fiscal year 2003-2004, the sum of $50 million plus accrued interestfor the repayment of such borrowing. The appropriations shall be made from the product of the sale of public improvement bonds issued during each of said fiscal years.

The Legislature is considering a bill to convert the Economic Development Bank for Puerto Rico (EDB) into a blended component unit of the Bank. By placing EDB under the sponsorship of the Bank, the bill intends to provide EDB with a reliable source of both capital and liquidity, which will allow EDB to continue fulfilling its role of providing financing to small and medium size businesses. Management is currently unable to assess if this bill, as drafted, will ultimately be approved or modified.

(7) CONTACTING THE BANK'S FINANCIAL MANAGEMENT

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

STATEMENT OF NET ASSETS

(A Component Unit of the Commonwealth of Puerto Rico)
June 30, 2002

	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTAL
ASSETS:			
Cash and due from banks	$ —	13,878,576	13,878,576
Federal funds sold	—	1,376,500,000	1,376,500,000
Deposits placed with banks	—	515,838,835	515,838,835
Investments and investment contracts	—	2,570,393,839	2,570,393,839
Loans receivable, net	—	2,229,643,229	2,229,643,229
Interest and other receivables	1,911,254	99,790,080	101,701,334
Due from Commonwealth of Puerto Rico	4,929,043	—	4,929,043
Due from other component units of the Commonwealth of Puerto Rico	1,227,468	—	1,227,468
Due from municipalities of Puerto Rico	250,000	—	250,000
Due from federal government	14,968,501	—	14,968,501
Internal balances	(51,876,036)	51,876,036	—
Restricted assets:			
Cash	3,456,561	11,022,622	14,479,183
Deposits placed with banks	11,514,004	52,250,307	63,764,311
Securities purchased under agreement to resell	—	170,000,000	170,000,000
Investments and investment contracts	319,134,828	1,173,725,442	1,492,860,270
Loans receivable, net	4,990,083	29,619,476	34,609,559
Real estate available for sale	—	35,243,769	35,243,769
Capital assets	—	16,624,875	16,624,875
Other assets	2,774,658	16,757,764	19,532,422
Total assets	313,280,364	8,363,164,850	8,676,445,214
LIABILITIES:			
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:			
Demand	—	2,070,536,111	2,070,536,111
Certificates of deposit	—	1,797,572,902	1,797,572,902
Certificates of indebtedness	—	294,591,425	294,591,425
Commercial paper	—	398,745,844	398,745,844
Accrued interest payable	—	15,381,613	15,381,613
Due to Commonwealth of Puerto Rico	75,000,000	162,027,099	237,027,099
Accounts payable and accrued liabilities	7,776,045	140,933,892	148,709,937
Allowance for losses on guarantees and letters of credit	—	35,874,349	35,874,349
Bonds payable due in more than one year	—	267,000,000	267,000,000
Note payable due in more than one year	10,029,360	—	10,029,360
Liabilities payable from restricted assets:			
Securities sold under agreement to repurchase	—	170,000,000	170,000,000
Accrued liabilities	—	8,470,586	8,470,586
Bonds payable:			
Due in one year	32,770,000	97,039,128	129,809,128
Due in more than one year	148,570,000	941,938,990	1,090,508,990
Total liabilities	274,145,405	6,400,111,939	6,674,257,344
NET ASSETS (DEFICIT):			
Invested in capital assets	—	16,624,875	16,624,875
Restricted for:			
Debt service	45,867,983	—	45,867,983
Affordable housing programs	184,636,336	165,107,902	349,744,238
Mortgage loan insurance	—	20,085,575	20,085,575
Unrestricted (deficit)	(191,369,360)	1,761,234,559	1,569,865,199
Total net assets	$ 39,134,959	1,963,052,911	2,002,187,870

See accompanying notes to basic financial statements.

STATEMENT OF ACTIVITIES

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)
Year ended June 30, 2002

	Expenses	Program Revenues: Charges for Services – Fees, Commissions, and Others	Program Revenues: Charges for Services – Financing and Investment	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expenses) Revenues and Changes in Net Assets: Governmental Activities	Net (Expenses) Revenues and Changes in Net Assets: Business-type Activities	Net (Expenses) Revenues and Changes in Net Assets: Total
Functions/programs:								
Governmental activities:								
General government	$ 1,960,549	—	—	—	—	(1,960,549)	—	(1,960,549)
Housing subsidy program	43,921,776	—	23,806,227	49,953,562	54,748,200	84,586,213	—	84,586,213
Interest on long-term debt	25,496,330	—	—	6,955,582	—	(18,540,748)	—	(18,540,748)
Total governmental activities	71,378,655	—	23,806,227	56,909,144	54,748,200	64,084,916	—	64,084,916
Business-type activities:								
GDB Operating Fund	260,470,542	17,985,733	345,977,104	—	—	—	103,492,295	103,492,295
Housing Finance Authority	205,955,066	12,519,991	134,499,689	112,707,578	—	—	53,772,192	53,772,192
Tourism Development Fund	9,257,788	7,243,815	3,114,355	50,000,000	—	—	51,100,382	51,100,382
Public Finance Corporation	37,331,784	—	7,943,728	32,056,387	—	—	2,668,331	2,668,331
Capital Fund	69,718	—	(20,310,434)	—	—	—	(20,380,152)	(20,380,152)
Development Fund	41,920	—	502,027	—	—	—	460,107	460,107
Total business-type activities	513,126,818	37,749,539	471,726,469	194,763,965	—	—	191,113,155	191,113,155
Total	$ 584,505,473	37,749,539	495,532,696	251,673,109	54,748,200	64,084,916	191,113,155	255,198,071
General revenues:								
Unrestricted income						760,108	—	760,108
Contributions to others						—	(38,262,025)	(38,262,025)
Transfers						3,755,282	(3,755,282)	—
Total general revenues and transfers						4,515,390	(42,017,307)	(37,501,917)
Change in net assets						68,600,306	149,095,848	217,696,154
Net assets (deficit), beginning of year						(29,465,347)	1,813,957,063	1,784,491,716
Net assets, end of year						$ 39,134,959	1,963,052,911	2,002,187,870

See accompanying notes to basic financial statements.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)
June 30, 2002

ASSETS	Affordable Housing Mortgage Subsidy Program - Stage 7	Subsidy Prepayment Refunding Bonds - Debt Service	New Secure Housing Program	Special Obligation Refunding Bonds - Debt Service	Other Nonmajor Governmental Funds	Total Governmental Funds
Interest and other receivables	$ —	189,028	(217)	241,384	1,481,059	1,911,254
Due from other funds	—	—	1,530,000	955,121	2,527,427	5,012,548
Due from Commonwealth of Puerto Rico	—	—	4,929,043	—	—	4,929,043
Due from other component units of the Commonwealth of Puerto Rico	—	—	1,227,468	—	—	1,227,468
Due from municipalities of Puerto Rico	—	—	250,000	—	—	250,000
Due from federal government	—	—	14,968,501	—	—	14,968,501
Restricted:						
Cash and due from banks	55,000	20,490	—	—	3,381,071	3,456,561
Deposits placed with banks	—	—	—	3,514,00	8,000,004	11,514,004
Investments and investment contracts	92,029,280	32,187,500	—	—	194,918,048	319,134,828
Loans	—	—	—	4,990,083	—	4,990,083
Due from other funds	—	346,154	1,740,281	5,801,234	39,296,558	47,184,227
Other assets	—	—	—	2,675,683	98,975	2,774,658
Total assets	$ 92,084,280	32,743,172	24,645,076	18,177,505	249,703,142	417,353,175
LIABILITIES AND FUND BALANCES						
Liabilities:						
Due to Commonwealth of Puerto Rico	$ 75,000,000	—	—	—	—	75,000,000
Accounts payable and accrued liabilities	—	75,936	7,507,545	—	192,564	7,776,045
Due to other funds	—	—	17,829,665	40,000	86,203,146	104,072,811
Deferred revenue	—	—	16,412,194	—	375	16,412,569
Total liabilities	75,000,000	75,936	41,749,404	40,000	86,396,085	203,261,425
Fund balances (deficit):						
Reserved for long-term loans receivable	—	—	—	2,261,075	—	2,261,075
Unreserved	17,084,280	32,667,236	(17,104,328)	15,876,430	163,307,057	211,830,675
Total fund balances	17,084,280	32,667,236	(17,104,328)	18,137,505	163,307,057	214,091,750
Total liabilities and fund balances	$ 92,084,280	32,743,172	24,645,076	18,177,505	249,703,142	
Amounts reported for governmental activities in the statement of net assets are different because:						
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds						16,412,569
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds						(191,369,360)
Net assets of governmental activities						$ 39,134,959

See accompanying notes to basic financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)
Year ended June 30, 2002

	Affordable Housing Mortgage Subsidy Program - Stage 7	Subsidy Prepayment Refunding Bonds - Debt Service	New Secure Housing Program	Special Obligation Refunding Bonds - Debt Service	Other Nonmajor Governmental Funds	Total Governmental Funds
Revenues:						
Commonwealth appropriations for repayment of bonds and subsidy programs	$ 16,783,804	32,209,396	7,137,685	6,955,582	4,755,000	67,841,467
Intergovernmental – federal government	—	—	27,403,308	—	—	27,403,308
Interest income on loans	—	—	—	2,228,961	—	2,228,961
Interest on investments	5,408,231	2,064,089	—	51,408	15,081,664	22,605,392
Change in fair value of investments	(1,728,556)	—	—	(457,413)	1,157,843	(1,028,126)
Other	741,149	5,276	—	19,980	(6,297)	760,108
Total revenues	21,204,628	34,278,761	34,540,993	8,798,518	20,988,210	119,811,110
Expenditures:						
Current:						
General government	31,206	—	—	1,704,781	224,562	1,960,549
Housing subsidy program	6,382,630	—	19,434,679	119,101	17,985,366	43,921,776
Debt service:						
Principal	—	25,630,000	—	12,505,000	6,990,000	45,125,000
Interest	8,493,205	8,617,624	1,247,220	781,024	6,357,257	25,496,330
Total expenditures	14,907,041	34,247,624	20,681,899	15,109,906	31,557,185	116,503,655
Excess (deficiency) of revenues over (under) expenditures	6,297,587	31,137	13,859,094	(6,311,388)	(10,568,975)	3,307,455
Other financing sources (uses):						
Transfers in	—	—	—	—	8,910,594	8,910,594
Transfers out	—	—	—	—	(5,155,312)	(5,155,312)
Proceeds from note payable	10,029,360	—	—	—	—	10,029,360
Total other financing sources and uses	10,029,360	—	—	—	3,755,282	13,784,642
Net change in fund balances	16,326,947	31,137	13,859,094	(6,311,388)	(6,813,693)	17,092,097
Fund balances (deficit), beginning of year, as restated	757,333	32,636,099	(30,963,422)	24,448,893	170,120,750	196,999,653
Fund balances (deficit), end of year	$ 17,084,280	32,667,236	(17,104,328)	18,137,505	163,307,057	214,091,750

See accompanying notes to basic financial statements.

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

Amounts reported for governmental activities in the statement of activities are different because:		
Net change in fund balances – total governmental funds	$	17,092,097
Governmental funds report debt proceeds as revenue; however, this transaction has no effect on net assets		(10,029,360)
Revenues in the statement of activities that do not provide current financial resources are not reported in the funds		16,412,569
Governmental funds report debt service payments on long term debt as expenditures. However, this transaction has no effect in net assets		45,125,000
Change in net assets of governmental activities	$	68,600,306

See accompanying notes to basic financial statements.

BALANCE SHEET – ENTERPRISE FUNDS

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)
June 30, 2002

ASSETS	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Education Assistance Corporation	Eliminations	Total
Assets:									
Current assets:									
Cash and due from banks	$ 15,902,502	5,707,871	—	12,636,698	75,094,710	1,298,846	—	(96,762,051)	13,878,576
Federal funds sold	1,376,500,000	—	—	—	—	—	—	—	1,376,500,000
Deposits placed with banks	445,000,000	54,975,660	—	—	32,766,161	863,176	—	(67,766,162)	465,838,835
Investments and investment contracts	1,098,246,597	4,796,433	56,998,029	—	3,139,153	4,111,453	—	(63,031,426)	1,104,260,239
Loans receivable, net	680,139,931	36,768,586	—	—	—	—	—	—	716,908,517
Accrued interest receivable	88,986,511	7,384,547	599	11,602	414,145	71,230	1,728	(878,508)	95,991,854
Other current receivables	2,823,52	3,445,05	—	—	1,018,477	—	—	(3,488,823)	3,798,226
Other assets	1,563,147	2,745,530	—	—	—	—	—	—	4,308,677
Due from (to) governmental funds	53,479,480	(1,603,444)	—	—	—	—	—	—	51,876,036
Total current assets	3,762,641,689	114,220,234	56,998,628	12,648,300	112,432,646	6,344,705	1,728	(231,926,970)	3,833,360,960
Noncurrent assets:									
Restricted:									
Cash	—	6,372,064	—	—	—	6,405,155	2,063,703	(3,818,300)	11,022,622
Securities purchased under agreement to resell	—	170,000,000	—	—	—	—	—	—	170,000,000
Deposits placed with banks	—	167,940,474	—	—	—	—	—	(115,690,167)	52,250,307
Investments and investments contracts	130,692,288	1,154,931,303	—	—	—	—	—	(111,898,149)	1,173,725,442
Loans receivable, net	—	29,619,476	—	—	—	—	—	—	29,619,476
Deposits placed with banks	50,000,000	—	—	—	7,838,224	—	—	(7,838,224)	50,000,000
Investments	1,511,384,974	—	—	18,679,818	13,236,573	3,117,05	—	(80,284,820)	1,466,133,600
Loans receivable, net	1,326,364,969	186,369,743	—	—	—	—	—	—	1,512,734,712
Real estate available for sale	21,728,932	9,970,846	—	—	3,543,991	—	—	—	35,243,769
Capital assets	14,608,025	2,008,270	—	—	8,580	—	—	—	16,624,875
Other assets	5,978,948	6,348,497	—	278	121,364	—	—	—	12,449,087
Total noncurrent assets	3,060,758,136	1,733,560,673	—	18,680,096	24,748,732	9,522,210	2,063,703	(319,529,660)	4,529,803,890
Total assets	$ 6,823,399,825	1,847,780,907	56,998,628	31,328,396	137,181,378	15,866,915	2,065,431	(551,456,630)	8,363,164,850

BALANCE SHEET – ENTERPRISE FUNDS, CONTINUED

June 30, 2002

LIABILITIES AND NET ASSETS	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Education Assistance Corporation	Eliminations	Total
Liabilities:									
Current liabilities:									
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:									
Demand	$ 2,174,356,005	—	—	—	—	—	—	(103,819,894)	2,070,536,111
Certificates of deposit	1,739,000,676	15,378	—	—	—	—	—	(183,456,329)	1,555,559,725
Certificates of indebtedness	60,000,000	—	—	—	—	—	—	—	60,000,000
Commercial paper	398,745,844	—	—	—	—	—	—	—	398,745,844
Accrued interest payable	12,468,998	3,791,123	—	—	—	—	—	(878,508)	15,381,613
Accounts payable and accrued liabilities	108,117,669	25,710,913	7,789	6,431	1,767,687	735,903	—	—	136,346,392
Allowance for losses on guarantees and letters of credit	—	—	—	—	18,709,272	—	—	—	18,709,272
Due to Commonwealth of Puerto Rico	25,299,573	136,727,526	—	—	—	—	—	—	162,027,099
Total current liabilities payable from unrestricted assets	4,517,988,765	166,244,940	7,789	6,431	20,476,959	735,903	—	(288,154,731)	4,417,306,056
Current liabilities payable from restricted assets – bonds payable	—	97,039,128	—	—	—	—	—	—	97,039,128
Total current liabilities	4,517,988,765	263,284,068	7,789	6,431	20,476,959	735,903	—	(288,154,731)	4,514,345,184
Noncurrent liabilities:									
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:									
Certificates of deposit	424,780,976	—	—	—	—	—	—	(182,767,799)	242,013,177
Certificates of indebtedness	234,591,425	—	—	—	—	—	—	—	234,591,425
Allowance for losses on guarantees and letters of credit	3,048,465	—	—	—	14,116,612	—	—	—	17,165,077
Accrued liabilities	587,500	—	—	—	—	4,000,000	—	—	4,587,500
Bonds payable	267,000,000	—	—	—	—	—	—	—	267,000,000
Restricted:									
Securities sold under agreement to repurchase	—	170,000,000	—	—	—	—	—	—	170,000,000
Accrued liabilities	—	—	—	—	—	6,405,155	2,065,431	—	8,470,586
Bonds payable	—	1,022,473,090	—	—	—	—	—	(80,534,100)	941,938,990
Total noncurrent liabilities	930,008,366	1,192,473,090	—	—	14,116,612	10,405,155	2,065,431	(263,301,899)	1,885,766,755
Total liabilities	5,447,997,131	1,455,757,158	7,789	6,431	34,593,571	11,141,058	2,065,431	(551,456,630)	6,400,111,939
Net assets:									
Invested in capital assets	14,608,025	2,008,270	—	—	8,580	—	—	—	16,624,875
Restricted for:									
Mortgage loan insurance	—	20,085,575	—	—	—	—	—	—	20,085,575
Affordable housing programs	—	165,107,902	—	—	—	—	—	—	165,107,902
Unrestricted	1,360,794,669	204,822,002	56,990,839	31,321,965	102,579,227	4,725,857	—	—	1,761,234,559
Total net assets	1,375,402,694	392,023,749	56,990,839	31,321,965	102,587,807	4,725,857	—	—	1,963,052,911
Total liabilities and net assets	$ 6,823,399,825	1,847,780,907	56,998,628	31,328,396	137,181,378	15,866,915	2,065,431	(551,456,630)	8,363,164,850

See accompanying notes to basic financial statements.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS – ENTERPRISE FUNDS

(A Component Unit of the Commonwealth of Puerto Rico)
Year ended June 30, 2002

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Total
Operating revenues:							
Investment income:							
Interest income on federal funds sold and securities purchased under agreements to resell	$ 26,469,187	4,758,472	—	—	—	—	31,227,659
Interest income on deposits placed with banks	6,289,391	1,761,089	—	257,019	1,792,613	17,551	10,117,663
Interest and dividend income on investment and investment contracts and tax lien receivables	62,627,937	86,428,867	551,264	—	1,080,972	7,926,177	158,615,217
Loans receivable:							
Public sector	225,628,186	—	—	—	—	—	225,628,186
Private sector	1,012,601	16,647,628	—	—	—	—	17,660,229
Total interest income	322,027,302	109,596,056	551,264	257,019	2,873,585	7,943,728	443,248,954
Noninterest income:							
Change in fair value of investments	23,939,804	22,394,001	(20,861,698)	245,008	240,770	—	25,957,885
Fiscal agency fees	10,449,115	—	—	—	—	—	10,449,115
Commitment, guarantee, service, and administrative fees	1,847,308	—	—	—	7,241,753	—	9,089,061
Mortgage insurance premiums	—	2,153,095	—	—	—	—	2,153,095
Servicing and contract administration fees, net	2,050,227	8,161,886	—	—	—	—	10,212,113
Net gain from sale of foreclosed real estate available for sale	—	2,509,632	—	—	—	—	2,509,632
Net gain on sale of capital assets	9,998	—	—	—	—	—	9,998
Payments from Commonwealth of Puerto Rico	—	380,828	—	—	—	—	380,828
Federal assistance programs	—	112,326,750	—	—	—	—	112,326,750
Other income	3,639,083	2,205,010	—	—	2,062	—	5,846,155
Total noninterest income (loss)	41,935,535	150,131,202	(20,861,698)	245,008	7,484,585	—	178,934,632
Total operating revenues	$ 363,962,837	259,727,258	(20,310,434)	502,027	10,358,170	7,943,728	622,183,586

(Continued)

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS – ENTERPRISE FUNDS, CONTINUED

(A Component Unit of the Commonwealth of Puerto Rico)
Year ended June 30, 2002

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Total
Operating expenses:							
Provision for loan losses	$ (1,500,000)	1,916,702	—	—	—	—	416,702
Interest expense:							
Deposits	101,074,861	—	—	—	—	—	101,074,861
Certificate of indebtedness	11,068,752	49,080	—	—	—	—	11,117,832
Securities sold under agreements to repurchase	232,275	4,692,158	—	—	—	—	4,924,433
Commercial paper	20,779,220	—	—	—	—	—	20,779,220
Bonds payable	8,633,713	73,758,100	—	—	—	10,028,397	92,420,210
Total interest expense	141,788,821	78,499,338	—	—	—	10,028,397	230,316,556
Noninterest expenses:							
Salaries and fringe benefits	17,419,183	7,993,191	—	393	18,363	—	25,431,130
Occupancy and equipment costs	6,386,121	1,097,022	—	—	3,178	—	7,486,321
Legal and professional fees	9,323,960	1,370,610	69,718	6,800	353,428	71,444	11,195,960
Office and administrative	2,178,546	424,735	—	—	6,152	—	2,609,433
Subsidy and trustee fees	—	1,443,573	—	—	—	6,833,759	8,277,332
Provision for losses on guarantees and letters of credit	—	—	—	—	8,500,000	—	8,500,000
Federal assistance programs	—	112,326,750	—	—	—	—	112,326,750
Other	22,396,062	883,145	—	34,727	376,667	819,646	24,510,247
Total noninterest expenses	57,703,872	125,539,026	69,718	41,920	9,257,788	7,724,849	200,337,173
Total operating expenses	197,992,693	205,955,066	69,718	41,920	9,257,788	17,753,246	431,070,431
Operating income (loss)	165,970,144	53,772,192	(20,380,152)	460,107	1,100,382	(9,809,518)	191,113,155
Contributions to others	(38,260,025)	(2,000)	—	—	—	—	(38,262,025)
Special item – net gain (loss) on early extinguishment of bonds	19,578,538	—	—	—	—	(19,578,538)	—
Transfers in	979,334	5,155,312	—	—	50,000,000	33,035,721	89,170,367
Transfers out	(83,035,721)	(8,910,594)	—	—	—	(979,334)	(92,925,649)
Change in net assets	65,232,270	50,014,910	(20,380,152)	460,107	51,100,382	2,668,331	149,095,848
Net assets, beginning of year, as restated	1,310,170,424	342,008,839	77,370,991	30,861,858	51,487,425	2,057,526	1,813,957,063
Net assets, end of year	$ 1,375,402,694	392,023,749	56,990,839	31,321,965	102,587,807	4,725,857	1,963,052,911

See accompanying notes to basic financial statements.

STATEMENT OF CASH FLOWS – ENTERPRISE FUNDS

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)
Year ended June 30, 2002

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Education Assistance Corporation	Eliminations	Total
Cash flows from operating activities:									
Cash received from interest on loans	$ —	16,070,412	—	—	—	—	—	—	16,070,412
Cash paid for mortgage and construction loans originated	—	(80,937,987)	—	—	—	—	—	—	(80,937,987)
Principal collected on mortgage and construction loans	—	34,026,697	—	—	—	—	—	—	34,026,697
Collection of accounts due from CRIM and the Commonwealth	132,776,696	—	—	—	—	145,544,269	—	—	278,320,965
Collection of tax lien receivables	—	—	—	—	—	23,648,482	—	—	23,648,482
Cash received from insurance premiums	—	2,153,095	—	—	—	—	—	—	2,153,095
Guarantee fees collected	—	—	—	—	6,548,370	—	—	—	6,548,370
Cash received for federal assistance programs	—	112,326,750	—	—	—	—	—	—	112,326,750
Cash payments on housing assistance programs	—	(112,326,750)	—	—	—	—	—	—	(112,326,750)
Cash received from other operating noninterest revenues	42,935,376	10,366,896	—	—	—	—	—	(5,756,587)	47,545,685
Cash payments for other operating noninterest expenses	(66,389,088)	(19,009,793)	(74,403)	(40,231)	(82,532)	(7,235,640)	21,458	—	(92,810,229)
Disbursements for obligations guaranteed	(12,710,966)	—	—	—	(6,674,116)	—	—	—	(19,385,082)
Cash payments for insurance premiums	—	—	—	—	—	(778,274)	—	—	(778,274)
Cash payments for salaries and fringe benefits	(17,419,183)	(7,993,191)	—	—	(18,363)	—	—	—	(25,430,737)
Net cash provided by (used in) operating activities	79,192,835	(45,323,871)	(74,403)	(40,231)	(226,641)	161,178,837	21,458	(5,756,587)	188,971,397
Cash flows from noncapital financing activities:									
Interfund loans	—	17,994,783	—	—	—	—	—	—	17,994,783
Contribution to others	(38,260,025)	(2,000)	—	—	—	—	—	—	(38,262,025)
Transfers in	979,334	5,155,312	—	—	50,000,000	33,035,721	—	—	89,170,367
Transfers out	(83,035,721)	(8,910,594)	—	—	—	(979,334)	—	—	(92,925,649)
Net increase (decrease) in:									
Deposits	930,877,103	15,378	—	—	—	—	—	(167,149,442)	763,743,039
Certificates of indebtedness	33,384,000	—	—	—	—	—	—	—	33,384,000
Securities sold under agreements to repurchase	—	(95,000,000)	—	—	—	—	—	15,000,000	(80,000,000)
Commercial paper	(853,247,475)	—	—	—	—	—	—	—	(853,247,475)
Proceeds from issuance of bonds	—	125,937,548	—	—	—	—	—	—	125,937,548
Repayments of bonds	—	(79,727,648)	—	—	—	(206,531,982)	—	(6,087,207)	(292,346,837)
Interest paid	(136,234,954)	(36,688,603)	—	—	—	(12,754,258)	—	(343,219)	(186,021,034)
Net cash (used in) provided by noncapital financing activities	$ (145,537,738)	(71,225,824)	—	—	50,000,000	(187,229,853)	—	(158,579,868)	(512,573,283)

(Continued)

STATEMENT OF CASH FLOWS – ENTERPRISE FUNDS, CONTINUED

(A Component Unit of the Commonwealth of Puerto Rico)
Year ended June 30, 2002

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Education Assistance Corporation	Eliminations	Total
Cash flows from capital and related financing activities:									
Purchase of capital assets	$ (762,665)	(1,446,805)	—	—	—	—	—	—	(2,209,470)
Proceeds from sales of capital assets	9,998	—	—	—	—	—	—	—	9,998
Net cash used in capital and related financing activities	(752,667)	(1,446,805)	—	—	—	—	—	—	(2,199,472)
Cash flows from investing activities:									
Net decrease (increase) in:									
Federal funds sold and securities purchased under agreements to resell	244,040,000	80,000,000	—	—	—	—	—	(15,000,000)	309,040,000
Deposits placed with banks	(495,000,000	(152,970,474)	—	—	(766,161)	4,224	—	93,456,329	(555,276,082)
Purchase of investment securities	(10,816,384,890)	(461,327,817)	(539,454)	(3,572,899)	(69,895)	—	—	212,625,068	(11,069,269,887)
Proceeds from redemptions of investments	8,035,964,843	455,027,154	61,349	—	7,714,661	24,273,624	—	(181,365,110)	8,341,676,521
Proceeds from sales of investments	986,651,172	—	—	—	—	—	—	—	986,651,172
Cash received from investment interest	74,469,673	90,858,921	552,508	289,103	2,953,746	8,257,200	3,761	343,219	177,728,131
Cash received from loans interest	317,916,166	—	—	—	—	—	—	—	317,916,166
Origination of loans	(2,489,620,796)	—	—	—	—	—	—	—	(2,489,620,796)
Principal collected on loans and sales of loans	4,212,651,624	—	—	—	—	—	—	—	4,212,651,624
Net proceeds from foreclosed real estate available for sale	—	3,740,342	—	—	—	—	—	—	3,740,342
Net cash provided by (used in) investing activities	70,687,792	15,328,126	74,403	(3,283,796)	9,832,351	32,535,048	3,761	110,059,506	235,237,191
Net change in cash	3,590,222	(102,668,374)	—	(3,324,027)	59,605,710	6,484,032	25,219	(54,276,949)	(90,564,167)
Cash, beginning of year	12,312,280	114,748,309	—	15,960,725	15,489,000	1,219,969	2,038,484	(46,303,402)	115,465,365
Cash, end of year	$ 15,902,502	12,079,935	—	12,636,698	75,094,710	7,704,001	2,063,703	(100,580,351)	24,901,198
Reconciliation to enterprise funds balance sheet:									
Cash – unrestricted	$ 15,902,502	5,707,871	—	12,636,698	75,094,710	1,298,846	—	(96,762,051)	13,878,576
Cash – restricted	—	6,372,064	—	—	—	6,405,155	2,063,703	(3,818,300)	11,022,622
Total cash at year-end	$ 15,902,502	12,079,935	—	12,636,698	75,094,710	7,704,001	2,063,703	(100,580,351)	24,901,198

(Continued)

STATEMENT OF CASH FLOWS – ENTERPRISE FUNDS, CONTINUED

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)
Year ended June 30, 2002

	GDB Operating Fund	Housing Finance Authority	Capital Fund	Development Fund	Tourism Development Fund	Public Finance Corporation	Education Assistance Corporation	Eliminations	Total
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:									
Operating income (loss)	$ 165,970,144	53,772,192	(20,380,152)	460,107	1,100,382	(9,809,518)	—	—	191,113,155
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:									
Investment income	(95,386,515)	(92,948,428)	(551,264)	(257,019)	(2,873,585)	(7,943,728)	—	—	(199,960,539)
Loans income	(226,640,787)	—	—	—	—	—	—	—	(226,640,787)
Interest expenses presented as a noncapital financing activity	141,788,821	78,499,338	—	—	—	10,028,397	—	—	230,316,556
Provision for loan losses	(1,500,000)	1,916,702	—	—	—	—	—	—	416,702
Provision for losses on guarantees and letters of credit	—	—	—	—	8,500,000	—	—	—	8,500,000
Provision for losses on other assets	295,000	—	—	—	—	—	—	—	295,000
Net decrease (increase) in fair value of investment	(23,939,804)	(22,394,001)	20,861,698	(245,008)	(240,770)	—	—	—	(25,957,885)
Net unrealized loss on derivatives	19,362,762	—	—	—	—	—	—	—	19,362,762
Net gain on sales of real estate available for sale	—	(2,509,632)	—	—	—	—	—	—	(2,509,632)
Depreciation and amortization	2,224,633	281,356	—	—	3,118	—	—	—	2,509,107
Changes in operating assets and liabilities:									
Net change in mortgage loans receivable	—	(47,458,108)	—	—	—	—	—	—	(47,458,108)
Change in interest receivable on mortgage loan	—	(30,398)	—	—	—	—	—	—	(30,398)
Decrease in other assets	152,372,708	(86,685)	—	64	(733,106)	41,372	—	(5,756,587)	145,837,766
Decrease in tax lien receivables	—	—	—	—	—	93,375,422	—	—	93,375,422
Decrease in receivable from Commonwealth and CRIM	—	—	—	—	—	75,817,329	—	—	75,817,329
Charges to allowance for possible losses on guarantees and letters of credit	(12,710,966)	—	—	—	(6,674,116)	—	—	—	(19,385,082)
Decrease (increase) in other liabilities	(42,643,161)	(14,366,207)	(4,685)	1,625	691,436	(330,437)	21,458	—	(56,629,971)
Net cash provid	$ 79,192,835	(45,323,871	(74,403)	(40,231)	(226,641)	161,178,837	21,458	(5,756,587)	188,971,397
Noncash investing and noncapital financing activities:									
Accretion of discount on investment securities and capitalized interest on loans	$ 93,482,182	546,818	—	—	—	—	—	—	94,029,000
Accretion of discount on:									
Nonparticipating investment contracts	5,955,381	—	—	—	—	—	—	—	5,955,381
Deposits	2,272,304	—	—	—	—	—	—	—	2,272,304
Certificate of indebtedness	7,991,425	—	—	—	—	—	—	—	7,991,425
Commercial paper	1,562,833	—	—	—	—	—	—	—	1,562,833
Bonds payable	—	38,411,182	—	—	—	—	—	—	38,411,182
Increase (decrease) in fair value of investment	23,939,804	22,394,001	(20,861,698)	245,008	240,770	—	—	—	25,957,885
Unrealized gain on embedded derivative	15,896,803	—	—	—	—	—	—	—	15,896,803
Unrealized loss on derivatives (included in other liabilities)	(35,259,565)	—	—	—	—	—	—	—	(35,259,565)
Amortization of bond issued cost (included in interest expenses)	730,266	1,223,316	—	—	—	—	—	—	1,953,582
Net gain (loss) on early extinguishment of bonds	19,578,538	—	—	—	—	(19,578,538)	—	—	—
Bond discounts	—	845,491	—	—	—	—	—	—	845,491
Bond issue costs withheld from bond proceeds	—	291,961	—	—	—	—	—	—	291,961

See accompanying notes to basic financial statements.

(1) REPORTING ENTITY

Government Development Bank for Puerto Rico (the Bank) 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.

Act. No. 82 of June 16, 2002 amended the Bank's enabling legislation, Act No. 17 of September 23, 1948, as amended. The amendment authorizes the Bank, beginning with fiscal year 2001, to transfer annually to the General Fund of the Commonwealth (General Fund), up to 10% of its "net income" (which the Bank has interpreted to mean change in net assets), or the amount of $10 million, whichever is greater. Accordingly, on June 28, 2002 the Bank transferred $10 million to the General Fund corresponding to fiscal year 2001, and accrued $25.3 million for fiscal year 2002.

The Bank has the following blended component units: Puerto Rico Housing Finance Authority (the Housing Finance Authority or the 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), 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 (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 substantively the same as that of the Bank. A copy of the financial statements of each blended component unit may be obtained from the Bank.

The Housing Finance Authority (originally named 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 mortgagee, 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.

Act No. 92 of August 4, 2001 designated the Housing Finance Authority, in conjunction with the Puerto Rico Department of Housing, as the entity responsible for certifying the 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 approval of Act No. 103 of August 11, 2001, as amended, resulted in the merger of Housing Finance Authority with the former Puerto Rico Housing Bank and Finance Agency (the Housing Bank) and increased the scope of the Authority's activities (see note 3 for additional information about Act No. 103 and its effects on the Housing Finance Authority). As a result of Act No. 103, the Authority is now engaged in other activities that were previously handled by the Housing Bank, some of which are business-type while others are governmental. Business-type activities assumed from the Housing Bank include the origination and servicing of mortgage loans (up to a maximum loan balance of $90,000) to low- and moderate-income families and the underwriting of credit insurance for qualifying mortgage loans originated by other financial institutions to qualifying families. Within the governmental funds transferred from the Housing Bank, the Authority administers and accounts for moneys provided by the Commonwealth and the federal government for housing programs. These programs are designed to grant subsidies to low- and moderate-income families for housing acquisitions and for principal and interest payments on mortgage loans originated by other financial institutions to qualifying families.

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 Treasury of the Commonwealth for deposit in the Commonwealth's 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, equity investments process through professional equity investment managers. In January 2002, the board of directors authorized an increase in the capitalization of the Capital Fund up to a maximum of 10% of the total capital of the Bank.

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 blended component unit were transferred to a guarantee agency designated by the U.S. Department of Education. The Education Assistance Corporation is currently inactive and is expected to be liquidated.

The Bank and its blended component units are exposed to various risks of loss related to torts, theft, casualty, errors and omissions, and other losses for which the Bank carries commercial insurance. Also, the Bank obtains workers' compensation coverage from another component unit of the Commonwealth. Settlements made during fiscal years 2002, 2001, and 2000 did not exceed insurance coverage.

(2) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Bank conform to 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 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.

The Bank has implemented GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus – an amendment of GASB Statements No. 21 and No. 34*, Statement No. 38, *Certain Financial Statement Note Disclosures,* and Interpretation No. 6*, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements,* as of July 1, 2001. The most significant changes upon adoption of these statements are:

- Government-wide financial statements (the statement of net assets and the statement of activities) and fund financial statements comprise the required basic financial statements. Both government-wide and fund financial statements categorize activities as either governmental or business-type. The Bank has both governmental and business-type activities.
- Government-wide financial statements are prepared using the accrual basis of accounting, and, therefore, reconciliation is required of governmental activities financial information reported in the government-wide financial statements with the corresponding information in the governmental fund financial statements, which are prepared using the modified accrual basis of accounting.
- Net assets are reported in three categories: invested in capital assets net of related debt, restricted, and unrestricted.
- Statement of net assets of enterprise funds distinguish between current and noncurrent assets and liabilities.
- Statement of revenues, expenses, and changes in net assets should distinguish between operating and nonoperating revenues and expenses. This statement also reports contributions, special and extraordinary items, and transfers separately at the bottom of the statement to arrive at the all-inclusive change in the net assets.

- Statement of cash flows are prepared using the direct method.
- Management's discussion and analysis of the entity's financial activities is presented as required supplementary information.
- Financial statement disclosure requirements are modified, established, and rescinded.

(a) 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 asset 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 contraints 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 revenue includes: (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 instead 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 financial statements have been classified into major 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. In the case of enterprise funds, each individual blended component unit of the Bank with the exception of the Authority has been reported as a separate major fund in the fund financial statements. In the case of the Authority, all of its activities not classified and reported as governmental funds have been reported as an enterprise fund of the Bank.

(b) 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 revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental Fund 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 it is 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 Authority considers revenue to be available if it is collected within 120 days of the end of the current fiscal year-end. Principal revenues sources considered susceptible to accrual include federal and local funds 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, 2002, has been reported only in the government-wide financial statements.
- Interest on general long-term obligations is 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 Authority are classified as major governmental funds:

- **Affordable Housing Mortgage Subsidy Program (Stage 7)** – This special revenue fund is used to account for the proceeds of specific revenue sources under Stage 7 that are legally restricted to expenditures to promote the origination of mortgage loans by commercial banks, to low- and moderate-income families. This fund is one of the nine funds that are under the Affordable Housing Mortgage Assistance Program of the Authority, more fully described below. The remaining eight funds are reported in other nonmajor governmental funds.

- **Subsidy Prepayment Refunding Bonds (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 as part of a former mortgage subsidy program (see note 13).
- **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.
- **Special Obligation Refunding Bonds** – This debt service fund accounts for the funds and assets transferred by the Commonwealth through legislative assignments and from the liquidator of the Puerto Rico Urban Renewal and Housing Corporation (CRUV), respectively, for the payment of CRUV Bonds.

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

- **Affordable Housing Mortgage Subsidy Program (the AHMSP)** – 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 the enterprise funds to provide the funding to promote such loan originations.

  The 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 a 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 Authority. Loans originated, as well as servicing, are kept by the originating financial institution.

  In addition, the Authority has another mortgage loan origination and servicing agreement that is similar to the previously described program 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.
- **The Key for Your Home Program** – It was created to provide subsidy to low- and moderate-income families against costs directly related to the purchase and rehabilitation of housing units. The initial funding of this program amounted to $7,265,685 resulting from the excess funding of the AHMSP.

Enterprise Fund 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. Each enterprise fund has the option under GASB, Statement 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting,* to elect to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless the particular FASB pronouncements conflicts with GASB pronouncements. The Bank's enterprise funds have elected to apply FASB pronouncements issued after the applicable date.

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 things. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Each blended component unit of the Bank with the exception of the Authority has been classified and reported as a separate enterprise fund of the Bank. In the case of the Authority, all of its activities not classified and reported as governmental funds have been reported as an enterprise fund of the Bank.

(c) 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 in the accompanying balance sheet – enterprise funds.

(d) 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; nonparticipating investment contracts, which are carried at cost; and investment positions in a 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 change in fair value of investments in the accompanying fund financial statements.

(e) Loans

Loans 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) 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.

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 intended 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 a specific sources of repayment with authorization in writing from both the Commonwealth's Governor and the Director of the Office of Management and Budget.

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 from these public corporations. Puerto Rico is one of the U.S. jurisdictions with the highest participation in the bond issuance market. 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 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 bonds 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. No loans were sold in 2002.

(f) 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 charge-off experience on financial guarantees and management's best judgment.

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 financial statements, and such differences may be material.

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. The Director of the OMB has to include the amount subject to reimbursement in the General Budget of the Commonwealth for the following fiscal year for the Legislature's consideration and approval. The Legislature is not obligated to authorize such appropriations. As of June 30, 2002, no reimbursements had been requested by the Executive Director of the Tourism Development Fund to the Director of the OMB. However, during the fiscal year ended June 30, 2002, the Tourism Development Fund made payments under its guarantees and letters of credits in an aggregate amount of $6.7 million (see note 15). Reimbursements from the Commonwealth, if any, will be recorded as a receivable to the extent appropriated by the Commonwealth's Legislature.

(g) Long-Term Obligations – Deferred Debt Issue Costs

In the government-wide financial statements, long-term debt and other long-term obligations are presented in the columns for governmental and business-type activities. The same is presented in the enterprise fund financial statements. Deferred issuance costs are deferred and amortized over the life of the debt. Issuance costs are reported as deferred charges (an asset) and are amortized over the term of the related debt. Issuance costs of the bonds accounted for in the governmental funds are recorded as expenditures when paid.

(h) 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 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 on sale related to foreclosed real estate available for sale are included within other – noninterest income in the accompanying statement of revenues, expenses, and changes in net assets.

(i) Capital Assets

Capital assets, which include premises and equipment, are stated at cost less accumulated depreciation and amortization. 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.

Generally, 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

(j) 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.

(k) Deferred Revenues

Deferred revenues at the fund level arise when potential revenue does not meet the available criterion for recognition in the current period. Available is defined as due at June 30, and collected within 120 days thereafter to pay obligations due at June 30. Deferred revenues at the government-wide level arise only when the state receives resources before it has a legal claim to them.

(l) 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.

(m) Housing Finance Authority Bonds

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 Authority are considered no-commitment debt and are excluded, along with the related assets held in trust, from the accompanying financial statements. The Bank 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 Authority are included in the accompanying financial statements either because they represent general obligations of the Housing Finance Authority or it maintains effective control over the assets transferred as collateral.

(n) No-Commitment Debt

From time to time, Public Finance Corporation issues bonds the proceeds of which are used to purchase from the GDB Operating Fund promissory notes of the Commonwealth, its instrumentalities, and public corporations. The bonds are limited obligations of 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 for, and therefore neither the bonds nor the notes purchased with the proceeds there from are presented in the accompanying financial statements.

(o) 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 appropriate for expenditure. Accordingly, the fund balance of the Special Obligation Refunding Bonds fund is reserved by $2,261,075 for loans not due within one year.

(p) 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.

(q) 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 revenue 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.

(r) Derivative Instruments and Hedging Activities

In June 1998, the FASB issued SFAS No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities*. The provisions of this statement changed the accounting treatment of derivative contracts employed as risk management strategies, as well as certain derivative-like instruments embedded in other contracts. SFAS No. 133 requires that all derivatives must be recorded on the balance sheet 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 adopted SFAS No. 133 as explained in the ensuing paragraphs.

For fair value hedges, in which derivatives hedge the fair value of assets and liabilities, changes in the fair value of derivatives 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, 2002, the Bank had no fair value hedging derivatives.

For cash flow hedges, in which derivatives hedge the variability of cash flows related to floating rate assets, liabilities, or forecasted transactions, the accounting treatment depends on the effectiveness of the hedge. To the extent these derivatives are effective in offsetting the variability of the hedged cash flows, 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. Prior to this guidance by the GASB, the Bank had decided not to adopt SFAS No. 133 for its existing cash flow hedges pending the resolution of this matter. Upon clarification by GASB of the nonapplicability of the concept of OCI to governmental entities, the Bank adopted SFAS No. 133, as modified by such clarification, and charged to operations for the fiscal year ended June 30, 2002 approximately $19.4 million in connection with its cash flow hedges outstanding at the end of the year.

The fair value of derivative instruments not designated for hedging is recorded by the Bank in the balance sheet, and the change in fair value is reported in operations, as required by this statement. 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.

(s) Future Adoption of Accounting Pronouncements

The Bank has not evaluated the effects of the following accounting standards which may have effects in the Bank's basic financial statements.

- **GASB No. 39** – *Determining Whether Certain Organizations are Component Units* – effective for fiscal years beginning after June 30, 2003.
- **FASB No. 143** – *Accounting for Asset Retirement Obligations* – effective for fiscal years beginning after June 15, 2002.
- **FASB No. 144** – *Accounting for the Impairment or Disposal of Long-Lived Assets* – effective for fiscal years beginning after December 15, 2002.
- **FASB No. 145** – *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections* – effective for fiscal years beginning after May 15, 2002.
- **FASB No. 146** – *Accounting for Costs Associated with Exit or Disposal of Activities* – effective for exit or disposal activities initiated after December 31, 2002.

(3) TRANSFER OF ASSETS AND OPERATIONS TO PUERTO RICO HOUSING FINANCE AUTHORITY

Act No. 103 of August 11, 2001, *Law of the Puerto Rico Housing Finance Authority*, renamed the Puerto Rico Housing Finance Corporation as the Puerto Rico Housing Finance Authority and dissolved the Housing Bank. As a result of this law, the Authority received all the assets, liabilities, program administration, and operations of the Housing Bank effective February 11, 2002. For financial reporting purposes, the Authority has accounted for the transfer of these assets, liabilities, and operations as if it had occurred as of the beginning of the fiscal year. The Legislation also established that the transfer of the net assets to the Authority would require the recognition of an amount due to the Commonwealth for the residual amount of unrestricted assets and liabilities.

The beginning fund balance of governmental funds and the beginning net assets of enterprise funds have been restated to reflect the resulting change in reporting entity. Also, as mentioned in note 1, the Authority was assigned the administration of the assets and operations of the New Secure Housing Program fund, which was previously administered by the Puerto Rico Infrastructure Financing Authority, an affiliate of the Bank and a component unit of the Commonwealth, which also resulted in changes to beginning fund balances.

In addition, as part of GASB 34 implementation, management evaluated the financial reporting policies of the individual funds formerly administered by the Housing Bank and, as part of this process, the basis of presentation of the Interim Loan Insurance Fund, a nonmajor fund, was changed from that of an enterprise fund type to a debt service fund – a governmental fund type. This change was made effective as of the beginning of year.

The following is a reconciliation of beginning fund balances of governmental funds and beginning net assets of enterprise funds, as previously reported, to beginning balances in the accompanying basic financial statements (amounts in thousands):

Governmental funds:	
Prior to the merger, the Bank had no governmental funds, therefore the beginning fund balance as previously reported is zero	$ —
Fund balances reported by the Housing Bank at June 30, 2001:	
Special revenue funds	203,788
Debt service funds	24,449
Subtotal	228,237
Assumption by Commonwealth of $75 million loan with the Bank	75,000
Recognition of net assets to be transferred to the Commonwealth pursuant to Act No. 103	(75,000)
Beginning fund deficit of the New Secure Housing Program, previously reported by the Puerto Rico Infrastructure Financing Authority	(30,963)
Change in reporting practice of the interim loan insurance fund from an enterprise fund to a governmental fund	18,046
Other restatement upon adoption of GASB Statement No. 34	(18,320)
Restated beginning fund balances	$ 197,000
Enterprise funds:	
Fund equity at June 30, 2001, as previously reported	$ 1,732,085
Equity of enterprise funds reported by the Housing Bank at June 30, 2001	176,055
Recognition of net assets to be transferred to the Commonwealth, pursuant to Act No. 103	(122,766)
Change in reporting practice of the interim loan insurance fund from an enterprise fund to a governmental fund	28,584
Beginning net assets, as restated	$ 1,813,958

In addition, at June 30, 1998, the Housing Bank (now the Authority) was the custodian of approximately $46.2 million restricted funds related to Act No. 59, *Law for the Wealthcare, Security, and Occupational Health of Workers*. On July 23, 1998, Act No. 160 was approved. This law amended Act No. 59 and ordered the Housing Bank, as custodian of the $46.2 million restricted funds, to transfer $25 million to the Commonwealth and $10 million to the Puerto Rico Family and Children Administration. The law also provided that all unused restricted funds held by the Housing Bank at December 31, 1998 should be transferred to the Commonwealth. At June 30, 2002, approximately $13.9 million has not yet been transferred by the Authority to the Commonwealth and, therefore, the Authority's management has included these funds in the enterprise funds as restricted cash and a liability.

(4) CASH AND DUE FROM BANKS, FEDERAL FUNDS SOLD, DEPOSITS PLACED WITH BANKS, AND SECURITIES PURCHASED UNDER AGREEMENT TO RESELL

The table presented below discloses the level of custody credit risk assumed by the Bank based upon how its deposits were insured or secured with collateral at June 30, 2002. Cash, restricted cash, and deposits consist mainly of deposits in banks and are categorized as follows:

- **Category 1** – insured or collateralized with securities held by the Bank or by its agent in the Bank's name.
- **Category 2** – Collateralized with securities held by the pledging financial institution's trust department or its agent in the Bank's name.
- **Category 3** – Uncollateralized.

The reported amount and depository bank balances of deposits with financial institutions at June 30, 2002 were as follows:

		Category			
	1	2	3	Carrying amount	Depository bank balance
Cash and due from banks	$ 1,593,860	—	26,763,899	28,357,759	30,408,488
Deposits placed with banks (nonparticipating investment contracts)	2,313,831	—	577,289,314	579,603,146	579,603,145
Federal funds sold	—	—	1,376,500,000	1,376,500,000	1,376,500,000
	$ 3,907,691	—	1,980,553,213	1,984,460,905	1,986,511,633

Reconciliation to government-wide statement of net assets:

Unrestricted:	
Cash and due from banks	$ 13,878,576
Deposits placed with banks	515,838,835
Federal funds sold	1,376,500,000
Total unrestricted	1,906,217,411
Restricted:	
Cash and due from banks	14,479,183
Deposits placed with banks	63,764,311
Total restricted	78,243,494
Total balance	$ 1,984,460,905

The Commonwealth requires that public funds deposited in commercial banks 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 unsecured and uncollateralized deposits in commercial banks are the amounts in excess of $100,000 of accounts held by trustees under trust indentures created in connection with the issuance of bonds.

Cash amounting to approximately $597,000 is restricted to comply with the provisions of an agreement between the Bank and the U.S. Department of Housing and Urban Development.

The reported amount and the fair value of securities purchased under agreement to resell at June 30, 2002 amounted to $170 million. At June 30, 2002, these agreements mature within 3 months. The average amount outstanding during the year amounted to approximately $196 million with the largest amount outstanding at any month-end amounting to approximately $250 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. This investment is part of the Bank's arbitrage activities, as permitted by law.

(5) 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
- Securities purchased under agreements to resell
- World Bank securities
- Mortgage- and asset-backed securities
- Corporate debt, including investment contracts
- Stock of corporations created under the laws of the United States 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 also establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories 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 Investment and Treasury Departments may enter into.

The accounting policy and legal and contractual provisions for investments are described in note 2. The Bank's investments are categorized as:

- **Category 1** – Insured or registered in the name of the Bank, or securities held by the Bank, or its agent in the Bank's name.
- **Category 2** – Uninsured and unregistered in the name of the Bank, with securities held by the counterparty's trust department or agent in the Bank's name.
- **Category 3** – Uninsured and unregistered in the name of the Bank, with securities held by the counterparty, or by its trust department, or agent not in the Bank's name.

The following table summarizes the investment risks of the Bank:

	Category				
Securities type	1	2	3	Carrying amount	Fair value
Obligations of the U.S. government, its agencies, and instrumentalities	$ 1,921,024,511	388,238	—	1,921,412,749	1,921,412,749
Mortgage-backed securities	132,625,500	1,011,031,347	—	1,143,656,847	1,143,656,847
Corporate debt	65,506,900	—	—	65,506,900	65,506,900
External investment pools	—	26,162,156	—	26,162,156	26,162,156
Equity securities	56,557,724	—	—	56,557,724	56,557,724
Total investments	$ 2,175,714,635	1,037,581,741	—	3,213,296,376	3,213,296,376
Noncategorized investment:					
Nonparticipating investment contracts				849,957,733	
Total investments				$ 4,063,254,109	
Reconciliation to government-wide statement of net assets:					
Unrestricted investments				$ 2,570,393,839	
Restricted investments				1,492,860,270	
Total investments				$ 4,063,254,109	

Investments in external investment pools were subject to regulatory oversight by the Commissioner of Financial Institutions of Puerto Rico, except for $440,305, which was not subject to regulatory oversight.

Investments and investment contracts, excluding equity securities and external investment pools, at June 30, 2002 are shown below by contractual maturity. 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.

	Obligations of the U.S. government, its agencies, and instrumentalities	Corporate debt	Non-participating investment contracts	Total
Within one year	$ 952,223,062	—	108,399,499	1,060,622,561
After one to five years	916,414,187	65,506,900	476,172,499	1,458,093,586
After five to ten years	—	—	—	—
After ten years	52,775,500	—	265,385,735	318,161,235
Total	$ 1,921,412,749	65,506,900	849,957,733	2,836,877,382
Mortgage-backed securities				1,143,656,847
Total				$ 3,980,534,229

As of June 30, 2002 the Bank had pledged investment and investment contracts to secure the following:

Payment of principal and interest on obligations issued by a blended component unit	$ 1,042,288,274
Securities sold under agreements to repurchase	170,480,967
Certificates of indebtedness	122,987,358

(6) LOANS RECEIVABLE, AND ALLOWANCE FOR LOAN AND RECEIVABLE LOSSES

Loans at June 30, 2002 consist of the outstanding balance of credit facilities granted to the following (in thousands):

	Governmental Activities	Enterprise Funds: GDB Operating Fund	Enterprise Funds: Housing Finance Authority	Total
Public corporations and agencies	$ —	1,139,357	—	1,139,357
Municipalities	—	849,472	—	849,472
Total loans to public entities	—	1,988,829	—	1,988,829
Private entities	4,990	20,985	273,732	299,707
Allowance for possible losses	—	(3,309)	(20,974)	(24,283)
	4,990	17,676	252,758	275,424
Balance, end of period	$ 4,990	2,006,505	252,758	2,264,253

Public sector loans, which as of June 30, 2002 were delinquent by 90 days or more, amounted to approximately $348 million. Of this total, nonaccrual loans amounted to approximately $46.9 million at June 30, 2002. The gross interest income that would have been recorded if these loans had been accruing in accordance with their original terms was approximately $3.3 million in 2002. Interest collected on these loans amounted to $3.1 million in 2002.

Act No. 164 of December 17, 2001 authorized the Department of the Treasury of the Commonwealth, the Bank and the OMB to restructure and refinance some public entities debt with the Bank that had no designated source of repayment. Projected debt at June 30, 2001 including accrued interest amounted to approximately $2.4 billion. The Legislature will assign annual payments from the General Budget of the Commonwealth not to exceed $225 million. Included in the refinancing were $116 million or 62% of the nonaccruing public loans. Act No. 164 also allowed the Bank to transfer or sell the loans or any resulting obligation to any financial institution or in the capital markets.

During the months of December 2001 and January 2002, the Public Finance Corporation, a blended component unit of the Bank, issued $1.9 billion of bonds, the proceeds of which were used to buy public loan notes from the Bank, which included $10.6 million of nonaccrued interest, then recognized as income. By June 30, 2002, the Corporation issued additional bonds in the amount of $593.6 million to purchase from the Bank two additional promissory notes issued by the Department of Health of the Commonwealth. These promissory notes were issued in connection with the restructuring and refinancing of certain loans pursuant to the terms of Act No. 164.

During the last quarter of fiscal year 2002, the Bank purchased from the Department of the Treasury of the Commonwealth certain accounts receivable from various municipalities and the Municipal Revenues Collection Center (CRIM by its Spanish acronym). Total face value of the accounts receivable from the municipalities was $41.8 million; discounted at 6.5% the purchase price amounted to $31.3 million. The receivable from CRIM has a face value of $97 million; discounted at 6.0% the purchase price amounted to $81.7 million. The receivables from the municipalities and CRIM have yearly maturities until June 30, 2024 and June 30, 2007, respectively.

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. These credit facilities amounted to $275.4 million at June 30, 2002. They also include the outstanding principal balance of mortgage loans ($257.7 million) granted by the Housing Finance Authority to developers of multifamily housing units in Puerto Rico.

Nonaccrual private sector loans amounted to approximately $40 million at June 30, 2002. The gross interest income that would have been recorded if these loans had been performing in accordance with their original terms would have amounted to $7 million in 2002. Interest collected on these loans amounted to approximately $96,000.

The following is a summary of the activity in the allowance for loan losses for the year ended June 30, 2002 (in thousands):

	Enterprise Funds		
	GDB Operating Fund	Housing Finance Authority	Total
Balance at beginning of period	$ 4,808,485	19,196,539	24,005,024
Provision for loan losses	(1,500,000)	1,916,702	416,702
Charge-offs	—	(139,088)	(139,088)
Balance at end of period	$ 3,308,485	20,974,153	24,282,638

The following is a summary of private sector loans of enterprise funds considered to be impaired as of June 30, 2002, and the related interest income for the year then ended (in thousands):

	Enterprise Funds		
	GDB Operating Fund	Housing Finance Authority	Total
Recorded investment of impaired loans:			
Not requiring an allowance for loan losses	$ 2,708	—	2,708
Requiring an allowance for loan losses	—	37,708	37,708
Total recorded investment in impaired loans	$ 2,708	37,708	40,416
Related valuation allowance	$ —	8,610	8,610
Average recorded investment on impaired loans	$ 2,649	42,752	45,401
Interest income recognized on impaired loans	$ 8	560	568

(7) DUE FROM FEDERAL GOVERNMENT

The amount due from the federal government of $14,968,501 consists of the reimbursement requests submitted to the federal government for eligible grants to pay 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 to the housing needs of those families living in areas subject to floods. Amounts collected are subject to compliance audits under OMB Circular A-133, and federal auditors. Management believes that it has complied with the terms of the grants, and that all amounts claimed will be collected and, therefore, no allowance for uncollectible accounts has been established in this regard.

(8) CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2002 was as follows:

	Beginning balance	Additions	Reductions	Ending balance
Business-type activities:				
Capital assets not being depreciated:				
Land	$ 2,955,000	1,265,000	—	4,220,000
Total capital assets not being depreciated	2,955,000	1,265,000	—	4,220,000
Capital assets being depreciated:				
Building	8,988,048	—	—	8,988,048
Leasehold improvements	1,227,530	11,911	—	1,239,441
Information systems	6,152,949	439,770	(1,307,139)	5,285,580
Office furniture and equipment	2,953,916	492,789	(192,401)	3,254,304
Vehicles	422,459	—	(48,637)	373,822
Total capital assets being depreciated	19,744,902	944,470	(1,548,177)	19,141,195
Less accumulated depreciation and amortization for:				
Building	(112,350)	(224,702)	—	(337,052)
Leasehold improvements	(491,857)	(163,338)	—	(655,195)
Information systems	(2,533,730)	(1,643,920)	542,440	(3,635,210)
Office furniture and equipment	(1,691,224)	(428,545)	192,401	(1,927,368)
Vehicles	(181,534)	(48,602)	48,641	(181,495)
Total accumulated depreciation and amortization	(5,010,695)	(2,509,107)	783,482	(6,736,320)
Total capital assets being depreciated, net	14,734,207	(1,564,637)	(764,695)	12,404,875
Total capital assets, net	$ 17,689,207	(299,637)	(764,695)	16,624,875

(9) DEPOSITS

Deposits consist predominantly of interest-bearing demand accounts, special government deposit accounts, and time deposits from the Commonwealth, its agencies, and instrumentalities and municipalities. Interest expense on these deposits amounted to approximately $101.1 million in 2002.

The Bank has a deposit from Microsoft, Inc. for $200 million on which it pays interest based on the appreciation of the Microsoft, Inc. shares, for which it has entered into a swap to manage such risk (see note 16).

(10) SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

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

Carrying amount at June 30, 2002	$ 170,000,000
Maximum amount outstanding at any month-end	250,000,000
Average amount outstanding during the year	213,031,805
Weighted average interest rate for the year	2.47%
Weighted average interest rate at year-end	1.99%

The following summarizes the securities sold under agreements to repurchase activity for fiscal year 2002:

	Beginning balance	Issuances	Maturity	Ending balance
GDB Operating Fund	$ —	296,026,000	296,026,000	—
Housing Finance Authority	250,000,000	210,000,000	290,000,000	170,000,000
Total	$ 250,000,000	506,026,000	586,026,000	170,000,000

All sales of investments under agreements to repurchase are for fixed terms. In investing the proceeds of securities sold under agreements to repurchase, the Bank's policy is for the term to maturity of investments to be on or before the maturity of the securities sold under agreements to repurchase. At June 30, 2002, securities sold under agreement to repurchase had a maturity of September 24, 2002.

(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 acts and that qualify for the benefits provided under Section 936 of the Internal Revenue Code. The following summarizes the certificates of indebtedness activity for fiscal year 2002:

	Beginning balance	Issuances	Discount	Maturity	Ending balance	Due within one year
GDB Operating Fund	$ 253,216,000	47,384,000	7,991,425	14,000,000	294,591,425	60,000,000

At June 30, 2002, the scheduled maturities of certificates of indebtedness are as follows:

Year ending June 30:		
2003	$	60,000,000
2004		—
2005		—
2006		179,216,000
2007		55,375,425
	$	294,591,425

(12) 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 acts 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, 2002	$	398,745,844
Maximum amount outstanding at any month-end		1,322,170,421
Average amount outstanding during the year		1,024,376,116
Weighted average interest rate for the year		2.03%
Weighted average interest rate at year-end		1.46%

The following summarizes the commercial paper activity for fiscal year 2002:

		Beginning balance	Issuances	Discount	Maturity	Ending balance
GDB Operating Fund	$	1,250,430,486	6,586,838,162	1,562,833	7,440,085,637	398,745,844

(13) BONDS PAYABLE, OTHER BORROWED FUNDS, AND NONCURRENT LIABILITIES

A detail of bonds payable and other borrowed funds activity for the year ended June 30, 2002 is as follows:

	Beginning balance	Issuances * Accretion	Reductions	Ending balance	Due within one year
Governmental activities:					
Commonwealth appropriation bonds and notes:					
Law 115 – Subsidy prepayment refunding bonds	$ 167,330,000	—	(25,630,000)	141,700,000	25,610,000
Special obligation refunding bonds	12,505,000	—	(12,505,000)	—	—
Note payable – Stage 7 Affordable Housing Mortgage Subsidy Program	—	10,029,360	—	10,029,360	—
Total Commonwealth appropriation bonds and notes	179,835,000	10,029,360	(38,135,000)	151,729,360	25,610,000
General obligation bonds:					
Loan insurance claims refunding bonds	46,630,000	—	(6,990,000)	39,640,000	7,160,000
Total – governmental activities	$ 226,465,000	10,029,360	(45,125,000)	191,369,360	32,770,000

	Beginning balance	Issuances * net accretion	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	1,300,113,874	—	(45,710,000)	1,254,403,874	45,720,000
Revenue bonds:					
Collateralized Mortgage Revenue Bonds	99,775,000	—	(7,275,000)	92,500,000	1,625,000
Single Family Mortgage RevenueBonds – Portfolio I	46,390,000	—	(1,665,000)	44,725,000	660,000
Single Family Mortgage Revenue Bonds – Portfolio II (net of elimination of $11,430,000)	21,110,000	—	(2,970,000)	18,140,000	110,000
Single Family Mortgage Revenue Bonds – Portfolio III	40,095,000	—	(2,180,000)	37,915,000	—
Single Family Mortgage Revenue Bonds – Portfolio IV	93,607,000	—	(1,620,000)	91,987,000	1,168,000
Mortgage Trust IV:					
Collateralized Mortgage Obligations	110,043,290	—	(11,170,818)	98,872,472	21,720,265
Homeownership Mortgage Revenue Bonds	112,335,000	—	(3,720,000)	108,615,000	670,000
Homeownership Mortgage Revenue Bonds 2001	—	127,075,000 *	(1,885,000)	125,190,000	25,390,000
Total revenue bonds	523,355,290	127,075,000	(32,485,818)	617,944,472	51,343,265
Sub-total Housing Finance Authority	1,823,469,164	127,075,000	(78,195,818)	1,872,348,346	97,063,265
Less:					
Unaccreted discount	788,578,028	35,741,900	—	752,836,128	24,137
Total Housing Finance Authority	1,034,891,136	162,816,900	(78,195,818)	1,119,512,218	97,039,128
Public Finance Corporation:					
Subordinated note	21,240,677	—	(21,240,677)	—	—
Revenue bonds:					
Tax Debt Collateralized Bonds	206,531,982	—	(206,531,982)	—	—
Total Public Finance Coporation	227,772,659	—	(227,772,659)	—	—
	1,529,663,795	162,816,900	(305,968,477)	1,386,512,218	97,039,128
Less:					
Intrafund elimination	74,446,893	(6,087,207)	—	80,534,100	—
Total business-type activities	$ 1,455,216,902	156,729,693	(305,968,477)	1,305,978,118	97,039,128

The annual debt service requirements to maturity, including principal and interest, for long-term debt as of June 30, 2002, are as follows:

		GDB Operating Fund	
		Business-type Activities	
		Principal	Interest
Year ending June 30:			
2003	$	—	2,990,400
2004		—	2,990,400
2005		—	2,990,400
2006		—	2,990,400
2007		—	2,990,400
2008-2012		—	14,952,000
2013-2017		267,000,000	7,476,000
	$	267,000,000	37,380,000

		Housing Finance Authority			
		Governmental Activities		Business-type Activities	
		Principal	Interest	Principal	Interest
Year ending June 30:					
2003	$	32,770,000	9,908,214	97,063,265	67,789,047
2004		34,497,436	8,184,639	48,551,000	65,656,367
2005		36,208,456	6,323,722	51,199,000	64,733,432
2006		36,445,837	4,383,890	83,252,589	62,028,018
2007		41,668,666	1,817,869	54,984,000	60,490,699
2008-2012		751,106	2,704,009	288,075,618	271,905,445
2013-2017		941,411	2,513,778	222,112,000	238,112,053
2018-2022		1,331,376	2,123,828	196,520,002	224,508,269
2023-2027		2,425,827	1,632,432	638,413,872	190,468,847
2028-2032		4,329,245	502,970	132,252,000	33,423,945
2033-2037		—	—	59,925,000	2,469,415
	$	191,369,360	40,095,351	1,872,348,346	1,281,585,537

Governmental Activities

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

Description and maturity date	Interest rate	Amount outstanding
Commonwealth Appropriation Bonds:		
Law 115 Subsidy Prepayment Refunding Bonds:		
December 1, 2002 and each December 1 thereafter to December 1, 2006	3.25% – 5.125%	$ 141,700,000
General Obligation Bonds:		
Loan insurance claims refunding bonds:		
December 1, 2002 and each December 1 thereafter to December 1, 2006	5.00% – 6.25%	39,640,000
Note payable Stage 7 Affordable Housing Mortgage Subsidy:		
June 30, 2003 and each June 30 thereafter to June 30, 2031	Note (c) below	10,029,360
Total governmental activities bonds and notes payable		$ 191,369,360

(a) Law 115 – Subsidy Prepayment Refunding Bonds

The principal and interest of the Subsidy Prepayment 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 Refunding Bonds Indenture.

(b) Loan Insurance Claims Refunding Bonds

The principal and interest of the Loan Insurance Claim 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 Loan Insurance Claim Refunding Bonds Indenture.

(c) Note Payable to Puerto Rico Public Finance Corporation

On December 27, 2001, the Authority entered into a loan agreement (the Note) with the GDB Operating Fund to finance a loan (the Old Note) of the Housing Bank, also with the GDB Operating Fund, as authorized by Act No. 164 of December 17, 2001. PFC acquired and restructured the Note through the issuance of its Commonwealth Appropriations Bonds (PFC Bonds). The PFC Bonds were issued under trust indenture whereby PFC pledged and sold the Note, along with other notes under the Act No. 164, to certain trustees and created a first lien on the revenue of the notes sold. The amount outstanding of the Note at June 30, 2002 was $10,029,360 and matures on June 30, 2031. Interest on the unpaid principal amount of the Note is equal to the applicable percentage of the aggregate interest payable on the PFC Bonds. Applicable percentage is the percentage representing the proportion of the amount paid by PFC on the PFC Bonds serviced by the Note to the aggregate amount paid by PFC on all the PFC Bonds issued by PFC under Act No. 164. As a result of this current refunding, the Authority increased its aggregate debt service payments by approximately $12.5 million over the next 30 years. The amount outstanding of the Old Note at the refinancing date, December 17, 2001, was $9,735,189.

Business-Type Activities

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

Description and maturity date	Interest rate	Amount outstanding
Adjustable Refunding Bonds:		
January 1, 2015	Variable, 1.12% at June 30, 2002	$ 267,000,000
Mortgage Trust III:		
January 1, 2001 and each July 1 and January 1 thereafter to July 1, 2011	Zero Coupon	179,181,427
January 1, 2001 and each July 1 and January 1 thereafter to January 1, 2021	Zero Coupon	244,521,501
January 1, 2026	Zero Coupon	80,534,100
Plus: unaccreted discount		750,166,846
Collateralized Mortgage Revenue Bonds:		
January 1, 2003 and every other January 1 thereafter to January 1, 2015	6.00% – 6.30%	31,475,000
January 1, 2022	6.40%	24,430,000
January 1, 2029	6.50%	36,595,000
Single Family Mortgage Revenue Bonds – Portfolio I:		
October 1, 2002 and each April 1 and October 1 thereafter to October 1, 2010	5.15% – 5.90%	7,000,000
October 1, 2015	6.10%	6,305,000
April 1, 2029	6.25%	31,420,000
Single Family Mortgage Revenue Bonds – Portfolio II:	6.10% – 7.23%	
December 1, 2002	6.30%	110,000
December 1, 2006	6.50%	1,650,000
December 1, 2023	7.00%	16,380,000
Single Family Mortgage Revenue Bonds – Portfolio III:		
February 1, 2003 and each February and August 1 to August 1, 2010	6.20% – 6.60%	8,980,000
August 1, 2017	6.75%	6,955,000
August 1, 2020	6.85%	4,040,000
August 1, 2029	7.00%	17,940,000
Balance carried forward		$ 1,714,683,874

Description and maturity date	Interest rate	Amount outstanding
Balance brought forward		$ 1,714,683,874
Single Family Mortgage Revenue Bonds – Portfolio IV:		
December 1, 2003 and each December 1 and June 1 to August 1, 2007	5.75% – 6.00%	7,448,000
December 1, 2015	6.15%	17,087,000
December 1, 2023	6.20%	29,263,000
December 1, 2026	6.20%	15,762,000
December 1, 2030	6.25%	22,427,000
Mortgage Trust IV:		
June 1, 2007	89% LIBID (up to 9%)	21,720,265
April 1, 2011	5.90%	34,818,589
May 1, 2015	6.00%	42,333,618
Homeownership Mortgage Revenue Bonds 2000 Series:		
December 1, 2002 and each December 1 thereafter to December 1, 2012	3.80% – 4.75%	17,725,000
June 1, 2020	4.40%	2,150,000
December 1, 2018	5.10%	14,975,000
June 1, 2020	5.15%	14,370,000
December 1, 2031	5.10%	21,990,000
December 1, 2032	5.20%	37,405,000
Homeownership Mortgage Revenue Bonds 2001 Series:		
June 1, 2003	3.35%	25,000,000
December 1, 2033	5.20%	22,520,000
December 1, 2002 and each December 1 thereafter to December 1, 2012	2.75% – 4.70%	19,095,000
December 1, 2023	5.50%	4,555,000
June 1, 2027	4.45%	23,975,000
June 1, 2028	5.30%	3,000,000
December 1, 2028	5.30%	27,045,000
Total		$ 2,139,348,346

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.

On August 1, 2001, the Authority issued $127,075,000 Homeownership Mortgage Revenue Bonds (Mortgage-Backed Securities) consisting of $22,520,000 2001 Series A bonds, $75 million 2001 Series B bonds, $4,555,000 2001 Series C Bonds and $25 million Home Mortgages Revenue Notes, Series 1 (collectively the Bonds and Notes). The proceeds from the Bonds and Notes were used to provide funds to purchase and transfer to the trustee mortgage-backed securities guaranteed by GNMA, Federal National Mortgage Association, or the Federal Home Loan Mortgage Association (collectively the Mortgage Certificates). The Mortgage Certificates are backed by pools of mortgage loans made by participating lending institutions to low- and moderate-income families to finance the purchase of qualified single-family residential housing in Puerto Rico. The 2001 Series A and C Bonds and the Home Mortgage Revenue Notes, Series 1, bear fixed interest rates of 5.20%, 5.50%, and 3.35%, respectively, payable semiannually on each June 1 and December 1. The 2001 Series B bonds bear fixed interest rates ranging from 2.75% to 4.70% payable semiannually on each June 1 and December 1. The Bonds and Notes are payable in full on their respective stated maturity dates and are subject to redemption prior to their stated maturity dates, including redemption at par. The Bonds and Notes are limited obligations of the Authority. The principal of and redemption premium, if any, and interest on the Bonds and Notes are payable solely from the proceeds of certain assets, including the Mortgage Certificates to be acquired from time to time by the trustee, certain investments and the proceeds of the Bonds and Notes.

On June 30, 1998, the Public Finance Corporation entered into a transaction, whereby it issued a limited-obligation bridge note (the Bridge Note) and a subordinated note (the Subordinated Note) to CRIM, in exchange for tax lien receivables amounting to approximately $323.9 million on properties in Puerto Rico, which receivables CRIM was entitled to collect. This transaction was entered into pursuant to Act No. 21 of June 26, 1997, as amended. As provided by Act No. 21, the receivables would accrue interest at a rate of 15%, compounded monthly, commencing on October 1, 1999. The amount payable under the Bridge Note was to bear no interest and was established to be equal to the proceeds of certain bonds to be issued by the Public Finance Corporation, net of: (1) reserves to be established under the bond indenture; and (2) the cost of issuance of the bonds. The amount payable under the Subordinated Note was to bear no interest and would be equal to the tax lien receivables purchased less the amount payable under the Bridge Note and $10,000. All payments due to the CRIM and CRIM's rights to receive such payments would be subordinated in all respects to the payment in full of any and all sums required to be paid to the bondholders, and no payments would be made under the Subordinated Note until such bondholders have been paid in full and the bond indenture is terminated.

In February 1999, the Public Finance Corporation issued $228.3 million Tax Debt Collateralized Bonds, Series 1999-1 (the Tax Debt Bonds) consisting of $192 million Class A Bonds (the Class A Bonds) and $36.3 million Class B Bonds (the Class B Bonds). The Class A Bonds bore interest at 6.15% and were to mature on April 15, 2008. The Class B Bonds bore interest at 6.79% and were to mature on April 15, 2008. The Tax Debt Bonds are special and limited nonrecourse obligations of the Public Finance Corporation, payable solely from: the tax lien receivables acquired from CRIM, including interest accrued; any real and personal property acquired by the Public Finance Corporation through foreclosure or otherwise in connection with the tax lien receivables; and certain reserves established in connection with the bond indenture. At that time, the principal Bridge Note was established to be $207.1 million, which Note was simultaneously paid in full to CRIM. The principal amount payable under the Subordinated Note was then determined to be approximately $116.8 million and, accordingly, was recorded at such amount. However, upon further analysis of the transaction during fiscal year 2001, management adjusted the amount of the subordinated obligation to CRIM to the extent that the estimated fair value of the tax lien receivables exceeded the aforementioned Bridge Note. The fair value of the tax lien receivables was estimated at approximately $228.3 million, the price at which the Tax Debt Bonds were issued. As a result, management adjusted the Public Finance Corporation's accounting records during 2001 reducing the balance of the tax liens receivables and the Subordinated Note by approximately $95.6 million, representing the difference between the face value of the tax lien receivables of $323.9 million originally recorded and their estimated fair value of $228.3 million.

Management had initially foreseen that the collection of tax lien receivables and the established reserves would be ultimately sufficient to pay the Tax Debt Bonds; consequently, in prior years any excess (shortfall) of revenue related to the assets held by the trustee under the bond indenture over expenses incurred in connection with the Tax Debt Bonds was deferred with a corresponding credit or charge to operations. With the cancellation of the tax debts transaction in fiscal year 2002 as described below, the balance of $33.3 million in deferred expenses and deferred bond issue costs was charged to operations and is included in net loss on early extinguishments of bonds in the accompanying statement of revenues, expenses, and changes in net assets – enterprise funds.

During fiscal years 2001 and 2002, the principal amount of approximately $145.5 million of tax lien receivables was identified as defective. Under the terms of the trust indenture, CRIM and the Commonwealth were obligated to replace these defective tax liens with either new tax liens or cash in their corresponding proportional share. Also as part of the cancellation of the tax debts transaction this amount was collected from CRIM and the Commonwealth as described below.

The unfolding of events in connection with the transaction prompted the Bank, the Commonwealth's Secretary of the Treasury, and CRIM to devise a plan to cancel the transaction. The Commonwealth's Secretary of the Treasury acknowledged that the Bank had sustained losses as a result of this transaction and agreed to compensate the Bank for past losses as well as for estimated losses to be incurred in the cancellation and unwinding of the tax debts transaction. Consequently, the Commonwealth committed $132 million for this purpose (herein referred to as Commonwealth's commitment amount) as part of the total amount to be refinanced under of Act No. 164 of December 17, 2001 (see note 6). Act No. 164 authorized certain government departments, agencies, and public corporations to refinance approximately $2.4 billion of their outstanding obligations with the Bank over a period not exceeding 30 years, and to be repaid with annual Commonwealth appropriations not to exceed $225 million. Shortly after the approval of Act No. 164, the Public Finance Corporation issued $812 million in Commonwealth Appropriation Bonds from which the Bank received the $132 million of Commonwealth's commitment amount for the cancellation of the tax debts transaction. Initially this amount was recorded as deferred credits and subsequently was used for the payment of defective tax liens and to offset the losses incurred in the process of early extinguishment of bonds.

Act No. 146 of October 11, 2001 authorized CRIM to obtain financing through a line of credit from the Bank (CRIM line), for the advance repayment of the outstanding balance of the Tax Debt Bonds and the corresponding return by the Corporation to CRIM of the tax lien receivables. The source of repayment of the CRIM line will come from the assignment by the consenting municipalities of their corresponding share to the increase of 0.48% in the municipal subsidy from the General Fund, which was approved by Act No. 99 of August 10, 2001 and became effective in fiscal year 2002; as well as from collections from the tax lien receivables and operational funds of the municipalities, if necessary.

During the months of February to April 2002 the Public Finance Corporation received from the GDB Operating Fund and CRIM and transferred to the trustee the funds necessary to cure the tax liens identified as defective, and to repay the Tax Debt Bonds that remained outstanding. The GDB Operating Fund provided $91.7 million from the proceeds of the Commonwealth's commitment amount and CRIM provided $101.6 million drawn from the CRIM line. The Bonds were repaid in full on April 16, 2002.

Upon notice of the intention of the Public Finance Corporation to cancel the transaction and terminate the servicing agreement dated February 1, 1999 between the Public Finance Corporation, Banco Popular de Puerto Rico as trustee and JER Revenue Services P.R., (JER or the servicer), JER filed suit against the Public Finance Corporation and CRIM for breach of contract and loss of revenue under the contract. The suit also involves a disagreement between the Public Finance Corporation and JER as to the treatment of funds received to cure defective tax lien receivables for purposes of the incentive fee due to the servicer under the servicing agreement. The Court ordered the Corporation to deposit $6.4 million in escrow in connection with the suit. A deposit and a reserve for said amount have been recorded in the books of the Public Finance Corporation. The Public Finance Corporation has also established an accrual, which, in the opinion of management, should be sufficient to cover any additional expenses, termination fees, or other costs from the complete cancellation of the agreements and transaction. Investments and investment contracts amounting to approximately $8.1 million at June 30, 2002 were held by trustee under the trust indenture created in connection with this transaction.

Subsequent to June 30, 2002, the Bank, CRIM, and JER were negotiating a settlement agreement to cancel the indenture and the servicing agreement and to settle all mutual claims among them. Similarly, the Public Finance Corporation, the Bank, the Department of the Treasury, and CRIM were negotiating a transferred tax debts assignment, allocation, and servicing agreement, with the purpose of transferring and assigning to CRIM the tax lien receivables for servicing and collection upon termination of the indenture and the servicing agreements, discharging the Public Finance Corporation of its obligations under the subordinated note and for the establishment of an order of priority for the distribution of future collections from the tax lien receivables. To date, neither of these agreements has been executed.

The activity for the noncurrent liabilities during 2002 follows:

		Enterprise Funds			
		GDB Operating Fund	Public Finance Corporation	Education Assistance Corporation	Total
Balance, beginning of period	$	—	—	2,044,000	2,044,000
Additions		587,500	10,405,155	21,431	11,014,186
Balance, end of period	$	587,500	10,405,155	2,065,431	13,058,186

(14) 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, 2002, the Housing Finance Authority had a restricted net asset for such purposes of approximately $20 million.

(15) FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the normal course of business, the Bank is party to transactions of financial instruments with off-balance sheet risk, to meet the financing needs of their customers and to reduce their own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and to purchase participations and mortgage-backed securities, standby letters of credit, financial guarantees, and interest rate exchange agreements. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the accompanying 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. The notional amounts for other off-balance sheet risks express the dollar volume of the transactions, but the credit risk might be lower.

At June 30, 2002, 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	$ 146,880
Private sector	727,927
Total	$ 874,807
Standby letters of credit:	
Public sector	$ 60,232
Private sector	118,570
Total	$ 178,802
Commitments to extend credit:	
Public sector	$ 1,155,559
Private sector	27,658
Total	$ 1,183,217
Commitments to purchase investments	$ 56,508

The financial guarantees and letters of credit for 2002 include approximately $607 million, issued by the Tourism Development Fund on several private hotel and tourism development projects. During 2002, the Tourism Development Fund covered the debt service payments on certain projects in the amount of $6.7 million.

Following is the 2002 activity for the noncurrent portion of the allowance for guarantees and letters of credit:

	Beginning balance	Provisions	Charges	Ending balance
GDB Operating Fund	$ 3,048,465	—	—	3,048,465
Tourism Development Fund	10,436,721	3,679,891	—	14,116,612
	$ 13,485,186	3,679,891	—	17,165,077

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, evaluate 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.

Commitments to purchase investments are agreements to acquire mortgage-backed securities at a fixed price on behalf of certain housing programs.

(16) DERIVATIVE INSTRUMENTS

At June 30, 2002, the Bank had outstanding interest-rate swap agreements with other financial institutions as shown below:

Notional amount	Floating rate indicator	Receives Type	Receives Rate at June 30, 2002	Pays Type	Pays Rate	Maturity date
$ 50,000	Libor	Variable	1.11%	Fixed	4.72%	July 1, 2006
60,000	Libor	Variable	1.11%	Fixed	4.71%	July 1, 2006
60,000	Libor	Variable	1.11%	Fixed	4.71%	July 1, 2006
267,000	VRDOs(1)	Variable	1.12%	Fixed	3.04%	August 1, 2004
200,000	MSFT(2)	Zero	—	Fixed	4.99%	February 28, 2006
$ 637,000						

(1) VRDOs – Variable Rate Demand Obligations. 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. The underlying bonds contain a put option permitting the bondholder to tender the bonds for purchase upon seven days' notice.

(2) MSFT – Microsoft share appreciation index which mirrors embedded derivative on $200 million Microsoft certificate of deposit

The Bank is exposed to credit loss in the event of nonperformance by the other parties to the interest-rate swap agreements. However, the Bank does not anticipate nonperformance by the counter parties.

(17) RETIREMENT SYSTEM

(a) 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, 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 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.

(b) Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends 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 to the above-mentioned plans during the year ended June 30, 2002 amounted to approximately $1,005,000. The Bank's contributions during the years ended June 30, 2002, 2001, and 2000 amounted to approximately $1,443,000, $1,133,000, and $1,126,000, respectively. These amounts represented 100% of the required contribution for the corresponding year.

Additional information on the Retirement System is provided in its stand-alone financial statements for the year ended June 30, 2002, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities, PO Box 42003, San Juan, PR 00940-2003.

(18) COMMITMENTS AND CONTINGENCIES

(a) 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 2008. Rent charged to operations in 2002 amounted to approximately $1.6 million.

At June 30, 2002 the minimum annual future rentals under the noncancelable leases were as follows:

Year ending June 30:		
2003	$	1,445,284
2004		1,481,377
2005		868,445
2006		754,418
2007		305,880
2008		152,940
Total	$	5,008,344

(b) Puerto Rico Art Museum

During fiscal year 1996, the board of directors of the Bank approved a resolution, to designate certain real estate owned by the Bank for the site of what is known as the Puerto Rico Art Museum (the Museum). The resolution also indicated that the Bank would refurbish the property, including the parking facilities. Total cost amounted to $54.9 million, which was previously charged to expenses of the Bank. The Museum has been organized as a not-for-profit organization and has a separate board of trustees. While legal title over the property remains with the Bank, it is currently expected that the property, excluding the parking facility, which is operated by the Bank, will be used indefinitely by the Museum at no charge by the Bank. As a result, any amounts incurred by the Bank have been charged to operations, including $1 million during fiscal year 2002. Capitalized costs related to the parking facilities amounted to approximately $8.9 million at June 30, 2002 and are included in the accompanying balance sheet.

During fiscal year 2002, the board of directors of the Bank also approved a resolution authorizing the Bank to contribute $2 million for the operating expenses of the Museum for fiscal year 2002. This contribution has been recognized as other noninterest expense within the accompanying statement of revenues, expenses and changes in net assets for 2002. Capitalized costs related to the parking facilities amounted to approximately $8.9 million at June 30, 2002 and are included in the accompanying balance sheet.

(c) Litigation

The Bank is defendant in several lawsuits arising out of the normal course of their 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.

(19) NO-COMMITMENT DEBT AND PROGRAMS SPONSORED BY THE HOUSING FINANCE AUTHORITY

The Public Finance Corporation has issued approximately $5 billion of Commonwealth appropriation bonds (the Bonds) maturing at various dates through 2031. The proceeds of the Bonds, except for approximately $298 million, 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 its instrumentalities, and public corporations (the Notes). The $298 million referred to above were used to refund a portion of certain bonds issued by the Public Finance Corporation (also no-commitment debt) in fiscal years 1995 and 2000. The outstanding balance of the Bonds at June 30, 2002 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, are 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 of 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 financial statements.

Certain bonds of the Housing Finance Authority are considered no-commitment debt as more fully described in note 1. At June 30, 2002, there were restricted assets held in trust by others, outstanding obligations, fund balances, and excess of fund revenue over expenses, net of transfers (all of which are excluded from the accompanying financial statements), as indicated below (unaudited):

Restricted assets	$	141,239,195
Restricted liabilities (no commitment debt)		124,235,633
Restricted fund balance	$	17,003,562
Excess of fund expenses over revenue	$	2,034,002

In addition, 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 revenue and expenses of such federal financial assistance are accounted for in the Housing Finance Authority Fund.

Revenues and expenses during 2002 in connection with the administration of the U.S. Housing Act Section 8 program amounted to $112,326,750. The above revenues include approximately $3,812,000 of administrative fees transferred to the Housing Finance Authority for services performed as contract administrator.

(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. It should be noted that 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, 2002, 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, commercial paper and accrued interest receivable and payable have been valued at the carrying amounts reflected in the balance sheet, 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 as to 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.

		Reported or notional amount	Fair value
		(In millions)	
Financial assets:			
Cash and due from banks	$	28	28
Federal funds sold and securities purchased under agreement to resell		1,547	1,547
Deposits placed with banks		580	581
Investments and investment contracts		4,063	4,118
Loans to public sector entities and municipalities		1,989	2,053
Accrued interest receivable		96	96
Financial liabilities:			
Demand deposits		2,071	2,071
Certificates of deposit		1,798	1,798
Certificates of indebtedness		295	295
Securities sold under agreement to repurchase		170	170
Commercial paper		399	399
Accrued interest payable		15	15
Bonds payable		1,487	1,280
Note payable		10	10
Derivative instruments:			
Interest rate exchange agreements		637	(22)
Equity index embedded on certificate of deposit		200	(31)

(21) INTERFUND BALANCES AND TRANSFERS

Following is a summary of the interfund balances as of June 30, 2002:

Receivable by	Payable by	Purpose	Interfund balances
Governmental funds:	Enterprise funds:		
New Secure Housing Program	Housing Finance Authority	Reimbursements of loan originations	$ 1,530,000
Special Obligation Refunding Bonds	Housing Finance Authority	Collection of mortgages of debt service fund	955,121
Other nonmajor fund (Portfolio IV)	Housing Finance Authority	Reimbursement of bond issue costs	2,527,427
Subsidy Prepayment Refunding Bonds	GDB Operating Fund	Demand deposit and accrued interest	346,154
Other nonmajor (Law 124)	GDB Operating Fund	Demand deposit and accrued interest	92,677
Special Obligation Refunding Bonds	GDB Operating Fund	Demand deposit and accrued interest	5,801,234
New Secure Housing Program	GDB Operating Fund	Demand deposit and accrued interest	1,740,281
Other nonmajor fund (Stage 8)	GDB Operating Fund	Certificate of deposit and accrued interest	29,158,827
Other nonmajor fund (Law 72)	GDB Operating Fund	Certificate of deposit and accrued interest	4,757,567
Other nonmajor fund (Key for your Home)	GDB Operating Fund	Certificate of deposit and accrued interest	5,501,803
Enterprise funds:	Governmental funds:		
Housing Finance Authority	Other nonmajor fund (Law 72)	Reimbursement of expenditures	(18,297)
Housing Finance Authority	Special Obligation Refunding Bonds	Reimbursement of expenditures	(40,000)
Housing Finance Authority	Other nonmajor fund (Key for Your Home)	Advances for subsidies	(1,484,503)
Housing Finance Authority	New Secure Housing Program	Advances for low-income housing	(1,866,304)
GDB Operating Fund	Other nonmajor fund (Key for Your Home)	Advance	(123,947)
GDB Operating Fund	Other nonmajor fund (Law 72)	Advance	(90,369)
GDB Operating Fund	Other nonmajor fund (Stage 8)	Loans and accrued interest	(84,700,346)
GDB Operating Fund	New Secure Housing Program	Loans and accrued interest	(15,963,361)
Total, net internal balances			$ (51,876,036)
Enterprise funds:	Enterprise funds:		
Housing Finance Authority	GDB Operating Fund	Demand deposit and accrued interest	$ 12,793,995
Development Fund	GDB Operating Fund	Demand deposit and accrued interest	12,648,300
Tourism Development Fund	GDB Operating Fund	Demand deposit and accrued interest	75,157,032
Public Finance Corporation	GDB Operating Fund	Demand deposit and accrued interest	1,244,254
Education Assistance Corporation	GDB Operating Fund	Demand deposit and accrued interest	2,065,431
Housing Finance Authority	GDB Operating Fund	Certificate of deposit and accrued interest	151,275,887
Tourism Development Fund	GDB Operating Fund	Certificate of deposit and accrued interest	40,767,120
Housing Finance Authority	GDB Operating Fund	Guarantee investment contract	174,970,511
GDB Operating Fund	Housing Finance Authority	Bonds payable	80,534,100
Totals			$ 551,456,630

Following is a summary of interfund transfers for the year:

Transfer out	Transfer in	Purpose	Amount
Governmental funds:	Enterprise funds:		
Other nonmajor fund (Portfolio III)	Housing Finance Authority	Operational transfer	$ 4,504,819
Other nonmajor fund (Portfolio IV)	Housing Finance Authority	Operational transfer	650,493
Enterprise funds:	Governmental funds:		
Housing Finance Authority (Portfolio III)	Other nonmajor fund	Operational transfer	8,910,594
Enterprise funds:	Enterprise funds:		
GDB Operating Fund	Tourism Fund	Investment in capital	50,000,000
GDB Operating Fund	Public Finance Corporation	Cancellation of bonds	33,035,721
Public Finance Corporation	GDB Operating Fund	Transfer of tax debts	979,334

(22) SUBSEQUENT EVENTS

(a) Payment Guarantee in favor of Ondeo de Puerto Rico, Inc.

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 guarantees 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.

(b) Transfer of $500 million to the Special Communities Perpetual Trust

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 Perpetual 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. The Joint Resolution calls for the disbursement of these funds from time to time, as needed by the Trust. No disbursements had been made as of the date of this report.

In addition, the Legislature approved 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. The 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 a 10 fiscal years starting with the budget of fiscal year 2003-2004, the sum of $50 million plus accrued interest for the repayment of such borrowing. The appropriations shall be made from the product of the sale of public improvement bonds issued during each of said fiscal years.

(c) Sale of Loans to Municipal Finance Agency

On December 5, 2002, the Bank sold municipal loans and bonds of various municipalities amounting to $448,520,000 to Puerto Rico Municipal Finance Agency, a component unit of the Commonwealth.

(d) Sale of Mortgage Loans

On September 30, 2002, the Authority sold mortgage loans with an outstanding balance of approximately $41.5 million to a third party, for $43 million, resulting in a gain on sale of approximately $1.5 million.

(e) Issuance of Revenue Bonds – Business-Type Activities

On November 1, 2002, the Authority issued $350,000,000 Single Family Mortgage Revenue Bonds, Portfolio IX (Mortgage-backed securities) consisting of:

Business-Type Activities Bonds Payable	Interest rate	Amount
Description and maturity dates:		
Single Family Mortgage Revenue Bonds – Portfolio IX:		
Serial bonds:		
Due on June 1, 2005 and every June 1 and December 1 thereafter through December 1, 2012	3.10% - 5.10%	$ 49,530,000
Term bonds – due on:		
December 1, 2017	5.40%	28,770,000
December 1, 2022	5.50%	49,455,000
June 1, 2032	5.60%	62,825,000
June 1, 2034	5.60%	159,420,000
Total		$ 350,000,000

The proceeds from these Bonds will be used to provide funds for a program under which the Authority will purchase and transfer to the trustee mortgage-backed securities guaranteed by certain mortgage certificates. The Mortgage Certificates will be backed by pools of mortgage loans made by participating lending institutions to low- and moderate-income families to finance the purchase of qualified single family residential housing in Puerto Rico. The Bonds maturing on or after June 1, 2010 are subject to redemption in whole or in part, at the option of the Authority, prior to their stated maturity at the following redemption prices:

Redemption period	Redemption price
June 1, 2010 to May 31, 2011	102%
June 1, 2011 to May 31, 2012	101%
June 1, 2012 and thereafter	100%

The Bonds are limited obligations of the Authority. The principal of and redemption premium, if any, and interest on the Bonds will be payable solely from the proceeds of certain assets, including the Mortgage Certificates to be acquired from time to time by the trustee, certain investments and proceeds of the Bonds. Since the Authority maintains effective control over the proceeds of the Bonds and the Mortgage Certificates, the mortgage-backed securities will be recorded on the books of the Authority.

(f) Payment of Amounts Due to Commonwealth of Puerto Rico

Subsequent to June 30, 2002, the Authority has already paid the following amounts to the Commonwealth:

- The credit line of $75 million in the governmental activities that arose from the payment by the Commonwealth of a loan due to the Bank.
- From the approximately $122.7 million in the business-type activities related to transfer of the net assets of the Housing Bank (see note 3), the Authority has paid approximately $110.2 million, with a remaining balance of approximately $12.5 million.