

Puerto Rico Public Finance Corporation

(A Component Unit of Government Development
Bank for Puerto Rico)

Basic Financial Statements and Required
Supplementary Information as of and for the
Year Ended June 30, 2011, and
Independent Auditors' Report

PUERTO RICO PUBLIC FINANCE CORPORATION
(A Component Unit of Government Development Bank for Puerto Rico)

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INDEPENDENT AUDITORS' REPORT

The Members of the Board of Directors of
Puerto Rico Public Finance Corporation:

We have audited the accompanying balance sheet of Puerto Rico Public Finance Corporation (the "Corporation"), a component unit of Government Development Bank for Puerto Rico, as of June 30, 2011, and the related statements of revenues, expenses, and change in net assets, and of cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Puerto Rico Public Finance Corporation as of June 30, 2011, and its change in net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 to 4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

December 1, 2011

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PUERTO RICO PUBLIC FINANCE CORPORATION
(A Component Unit of Government Development Bank for Puerto Rico)

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

As management of the Puerto Rico Public Finance Corporation (the "Corporation"), we offer readers of the Corporation's financial statements this narrative overview and analysis of the Corporation's financial performance during the fiscal year ended June 30, 2011. Please read it in conjunction with the Corporation's basic financial statements, which follow this section.

(1) Financial Highlights

Total assets decreased by approximately \$15,000 or 1.4% from prior year and total liabilities also decreased by approximately \$12,000 or 19.4% from prior year.

(2) Overview of the Financial Statements

This report includes this management's discussion and analysis section, the independent auditors' report and the basic financial statements of the Corporation. The financial statements also include notes that explain in more detail information pertinent to the financial statements.

(3) Required Financial Statements

The financial statements of the Corporation report information using accounting methods similar to those used by private sector entities. The balance sheet includes all of the Corporation's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the Corporation and assessing its liquidity and financial flexibility.

Revenues and expenses are accounted for in the statement of revenues, expenses, and change in net assets. This statement measures the results of the Corporation's operations over the past year and can be used to determine whether the Corporation has successfully recovered its costs from the revenue it generates.

The final required financial statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and capital and noncapital financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

PUERTO RICO PUBLIC FINANCE CORPORATION
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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2011

(4) Financial Analysis of the Corporation

The balance sheet and the statement of revenues, expenses, and change in net assets report information about the Corporation's activities in a way that will help determine whether the Corporation as a whole is better or worse financially as a result of this year's activities. These two statements report the net assets of the Corporation and the changes in them. One can think of the Corporation's net assets — the difference between assets and liabilities — as one way to measure financial health or financial position. Over time, increases or decreases in the Corporation's net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other nonfinancial factors such as changes in economic conditions and new or changed government legislation.

(5) Net Assets and Changes in Net Assets

Condensed financial information on assets, liabilities, and net assets is presented below (amounts in thousands):

	<u>June 30,</u>		<u>Change</u>	
	2011	2010	Amount	Percent
Current assets	<u>\$ 1,039</u>	<u>\$ 1,054</u>	<u>\$ (15)</u>	(1.4)%
Current liabilities	\$ 50	\$ 62	\$ (12)	(19.4)%
Unrestricted net assets	<u>989</u>	<u>992</u>	<u>(3)</u>	(0.3)%
Total liabilities and net assets	<u>\$ 1,039</u>	<u>\$ 1,054</u>	<u>\$ (15)</u>	(1.4)%

Total assets decreased by approximately \$15,000 or 1.4% from prior year. Total liabilities also decreased by \$12,000 or 19.4%. In both cases, the decrease is attributed to payments of accrued costs of issuance of several bond issues.

PUERTO RICO PUBLIC FINANCE CORPORATION
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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2011

Condensed financial information on revenues, expenses, and changes in net assets is presented below (amounts in thousands):

	Year Ended		Change	
	June 30,		Amount	Percent
	2011	2010		
Operating revenues – Interest income	\$ 1	\$ 4,679	\$ (4,678)	(100.0)%
Total operating expenses	<u>4</u>	<u>4,682</u>	<u>(4,678)</u>	(99.9)%
Operating loss and change in net assets	(3)	(3)	0	0.0 %
Beginning – net assets	<u>992</u>	<u>995</u>	<u>(3)</u>	(0.3)%
Ending – net assets	<u>\$ 989</u>	<u>\$ 992</u>	<u>\$ (3)</u>	(0.3)%

The year ended with net assets of approximately \$989 thousand, a decrease of \$3 thousand or 0.3% from the net assets at the end of fiscal year 2010.

(6) Debt Administration

Conduit Debt

The Corporation's main operations consist of issuing special appropriation bonds that are considered "no-commitment debt" and, therefore, neither these bonds nor the related promissory notes held by the Corporation are presented in the accompanying basic financial statements. The special appropriation bonds are special and limited obligations of the Corporation and, except to the extent payable from bond proceeds and investments thereof, are payable solely from legislative appropriations provided by the Commonwealth of Puerto Rico. During the last three fiscal years, the special appropriation bonds were paid from certain funds obtained by the Puerto Rico Sales Tax Financing Authority, a component unit of the Commonwealth. However, from fiscal year 2012, the Commonwealth of Puerto Rico will continue with the repayment of the bonds.

At June 30, 2011, the Corporation had approximately \$1.6 billion in special appropriation bonds outstanding. See Note 4 to the basic financial statements for additional information about these special appropriation bonds.

(7) Contacting the Corporation's Financial Management

This financial report is designed to provide a general overview of the Corporation's finances for those interested. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Puerto Rico Public Finance Corporation, PO Box 42001, San Juan, Puerto Rico, 00940-2001.

PUERTO RICO PUBLIC FINANCE CORPORATION
(A Component Unit of Government Development Bank for Puerto Rico)

BALANCE SHEET
AS OF JUNE 30, 2011

ASSETS

CURRENT ASSETS:

Cash	\$ 1,039,120
Accrued interest receivable	<u>87</u>
Total current assets	<u>\$ 1,039,207</u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES - Accounts payable and accrued liabilities	\$ 49,960
UNRESTRICTED NET ASSETS	<u>989,247</u>
TOTAL	<u>\$ 1,039,207</u>

See notes to basic financial statements.

PUERTO RICO PUBLIC FINANCE CORPORATION
(A Component Unit of Government Development Bank for Puerto Rico)

STATEMENT OF REVENUES, EXPENSES, AND CHANGE IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2011

OPERATING REVENUES — Interest income on deposits	\$ 1,057
OPERATING EXPENSES — Professional fees	<u>3,990</u>
OPERATING LOSS AND CHANGE IN NET ASSETS	(2,933)
NET ASSETS — Beginning of year	<u>992,180</u>
NET ASSETS — End of year	<u>\$ 989,247</u>

See notes to basic financial statements.

PUERTO RICO PUBLIC FINANCE CORPORATION
(A Component Unit of Government Development Bank for Puerto Rico)

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2011

CASH FLOWS FROM OPERATING ACTIVITIES — Professional fees paid	\$ (16,381)
CASH FLOWS FROM INVESTING ACTIVITIES — Interest collected	<u>1,058</u>
NET DECREASE IN CASH	(15,323)
CASH — Beginning of year	<u>1,054,443</u>
CASH — End of year	<u>\$ 1,039,120</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:	
Operating loss	\$ (2,933)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Interest income on deposits	(1,057)
Decrease in accounts payable and accrued liabilities	<u>(12,391)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (16,381)</u>

See notes to basic financial statements.

PUERTO RICO PUBLIC FINANCE CORPORATION
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NOTES TO BASIC FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2011

1. REPORTING ENTITY

Puerto Rico Public Finance Corporation (the “Corporation”) is a component unit of Government Development Bank for Puerto Rico (the “Bank”), which is a component unit of the Commonwealth of Puerto Rico (the “Commonwealth”).

The Corporation was created by Resolution Number 5044 (the “Resolution”) of the Bank’s board of directors on December 12, 1984 to provide the agencies, instrumentalities, commissions, authorities, municipalities, and political subdivisions of the Commonwealth with alternate means of meeting their financing requirements. The Corporation is exempt from taxation in Puerto Rico.

The Resolution creating the Corporation states that if the Corporation was to be dissolved or cease to exist without a successor public entity being appointed, any funds or other assets of the Corporation which are not required for the payment of its bonds or any other obligations will be transferred to the Secretary of the Treasury of the Commonwealth for deposit in the General Fund of the Commonwealth.

The Corporation has no employees. The Bank provides certain management and administrative services to the Corporation at no cost.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America (“U.S. GAAP”), as applicable to governmental entities. The Corporation follows Governmental Accounting Standards Board (“GASB”) under the hierarchy established by Statement No. 55, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments, in the preparation of its financial statements. The Corporation has elected to apply all Financial Accounting Standards Board’s pronouncements issued after November 30, 1989, in accounting and reporting for its enterprise activities to the extent they do not conflict with GASB pronouncements.

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

Following is a description of the Corporation’s most significant accounting policies:

Measurement Focus, Basis of Accounting and Financial Statement Presentation — The Corporation’s 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 incurred, regardless of the timing of related cash flows.

Operating Revenues and Expenses— Operating revenues and expenses are distinguished from nonoperating items. The principal operating revenues of the Corporation are those derived from interest earned on deposits and other interest earning assets. Operating expenses include interest expense and, general and administrative expenses of the Corporation. All revenues and expenses not meeting these criteria are reported as nonoperating revenues and expenses.

Revenue Bonds and Related Loans— Certain bonds issued by the Corporation are considered “no-commitment debt” (Note 4) and, therefore, neither the bonds nor the notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements.

3. CASH

Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the Corporation may not be able to recover its deposits. The depository bank balance, which equals the bank balance, of \$1,039,120 as of June 30, 2011 represents interest-bearing demand deposits with the Bank and was uninsured and uncollateralized. The Corporation does not have a formal policy for custodial credit risk for deposits.

4. NO-COMMITMENT DEBT

The Corporation has issued approximately \$5.9 billion of Commonwealth appropriation bonds (the “Bonds”) maturing at various dates through 2032. The proceeds of the Bonds, except for approximately \$1.7 billion, were used to provide the necessary funds to purchase from the Bank separate promissory notes of the Department of the Treasury of the Commonwealth, and certain of its instrumentalities and public corporations (the “Promissory Notes”). The \$1.7 billion referred to above were used to refund a portion of certain bonds issued by the Corporation (also no-commitment debt) between fiscal years 1995 and 2005. The outstanding balance of the Bonds at June 30, 2011 amounted to approximately \$1.6 billion.

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

5. SUBSEQUENT EVENT

On August 18, 2011, the Corporation issued its 2011 Series A Bonds (Commonwealth Appropriation Bonds) for \$242,430,000 for the purpose of refunding a portion of its 2004 Series A Bonds, paying interest on the 2011 Series A Bonds through February 1, 2012, and paying costs of issuance of the 2011 Series A Bonds. The 2011 Series A Bonds were issued under a Trust Agreement dated as of June 1, 2004 by and between the Corporation and US Bank Trust National Association, as Trustee. These bonds will be payable solely from a pledge and assignment of amounts due under certain promissory notes (the “Notes”). The Notes are payable solely from appropriations approved by the Legislature of Puerto Rico. The appropriation acts require the OMB to include in the annual operating budget of the Commonwealth amounts required to pay the debt service on the Notes.

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