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ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

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

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KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

The Audit Committee
Economic Development Bank for Puerto Rico:

We have audited the accompanying financial statements of the business-type activities, the major fund and the remaining fund information of Economic Development Bank for Puerto Rico (the Bank), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2012 and 2011, which collectively comprise the Bank's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, its major fund and the remaining fund information of Economic Development Bank for Puerto Rico as of June 30, 2012 and 2011, and the respective changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 2 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

October 1, 2012

Stamp No. E44968 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report

This financial discussion contains an analysis of the statements of net assets of the Economic Development Bank for Puerto Rico (the Bank) as of June 30, 2012 and 2011, and its changes in financial position for the years then ended. The information included in this section should be read in conjunction with the basic financial statements of the Bank and its notes.

The business-type activities of the Bank are accounted for as enterprise funds, which include the activities of the Bank's principal operating fund and those of the Bank's blended component unit, Economic Development Bank Capital Investment (EDBCI). EDBCI was created to account for and focus separately on the activities and investments in local equity and venture capital funds. The required financial statements for an enterprise fund are as follows: statement of net assets; statement of revenue, expenses, and changes in net assets; and statement of cash flows. These financial statements report information using accounting methods similar to those used by private financial institutions.

The statement of net assets includes all the Bank's assets and liabilities, classified as current, noncurrent, capital assets, and net assets. This statement provides information as of a specific date about the nature and amount of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the Bank's capital structure.

The statement of revenue, expenses, and changes in net assets includes revenue earned and expenses incurred by the Bank for a specific period of time (12 operating months beginning on July 1 and ending on June 30). This statement measures the results of the Bank's operation and can be used to determine whether the Bank has successfully recovered all its costs through user fees and other charges. This statement distinguishes interest and noninterest revenue and expenses.

The statement of cash flows reports cash receipts, cash payments, and changes in cash resulting from operations, noncapital financing, capital and related financing, and investing activities. This statement provides information about the Bank's cash flows and how cash is obtained, used, and what was the change in cash balance during the reporting period beginning on July 1 and ending on June 30.

Financial Highlights

- Increase in net assets amounted to $10.3 million in 2012, a $8.1 million or 370% rise from a $2.2 million increase in net assets in 2011.
- Interest income from loans amounted to $12.2 million in 2012, a $2.2 million or approximately 22.1% increase from $10 million in 2011.
- Total interest income from investments increased by approximately 25% or $11.1 million, from $44.3 million in 2011 to $55.4 million in 2012, and total interest expense increased by 19.6% or $7.6 million, from $38.8 million in 2011 to $46.4 million in 2012. Refer to Comparison of 2012 and 2011 Revenue, Expenses and Changes in Net Assets section in the Management's Discussion and Analysis.
- Loan disbursements increased $21.6 million or 17.5%, from $123.5 million in 2011 to $145.1 million in 2012, and loan collections increased $15 million or 15.3%, from $98.5 million in 2011 to $113.5 million in 2012.
- Gross loan portfolio increased 6.4%, from $254.5 million in 2011 to $270.7 million in 2012.

Comparison of 2012 and 2011 Assets, Liabilities, and Net Assets

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

Net assets		2012	2011	Increase (decrease) Amount	Percentage
Current assets	$	378,109	415,581	(37,472)	(9.02)%
Noncurrent assets		1,200,981	963,453	237,528	24.65
Total assets	$	1,579,090	1,379,034	200,056	14.51
Current liabilities	$	700,779	551,165	149,614	27.15
Noncurrent liabilities		720,798	680,691	40,107	5.89
Total liabilities		1,421,577	1,231,856	189,721	15.40
Net assets:					
Invested in capital assets, net of related debt		(710)	(935)	225	24.06
Restricted for special loan programs		13,158	8,449	4,709	55.73
Unrestricted		145,065	139,664	5,401	3.87
		157,513	147,178	10,335	7.02
Total liabilities and net assets	$	1,579,090	1,379,034	200,056	14.51

At June 30, 2012, the Bank's total assets were $1,579.1 million ($323.1 million from EDBCI) compared to $1,379 million at June 30, 2011 ($323.4 million from EDBCI). The increase of $200.1 million represents 14.5% of the 2011 total assets balance.

Total loan portfolio increased by 3.7% when compared to balances as of June 30, 2011. Loan disbursements increased from $123.5 million in 2011 to $145.1 million in 2012, while principal collected on loans increased from $98.5 million for fiscal year 2011 to $113.5 million for fiscal year 2012. The related allowance for loan losses decreased by $3.1 million or 9.2% of the 2011 balance. The net loan portfolio increased by $19.3 million.

Interest-bearing deposits with other banks, commercial paper, investments, and securities purchased under agreements to resell increased by $178.9 million when compared to balances as of June 30, 2011, mainly due to a $117.9 million net increase in promissory notes and an increase of $89 million in time deposits.

At June 30, 2012, the Bank's total liabilities were $1,421.6 million compared to $1,231.9 million at June 30, 2011. The increase of $189.7 million represents 15.4% of the 2011 total liabilities.

Total time deposits were $543.6 million as of June 30, 2012. Time deposits consist primarily of certificates of deposit of public funds from other governmental institutions, which totaled $482 million. Deposits from other financial institutions were $61.6 million. Total time deposits increased by $89 million. As of year-end, the total promissory notes and other note payable balance was $736 million.

Securities sold under agreement to repurchase decreased by $13.5 million, from $137.4 million in 2011 to $123.9 million in 2012. Fluctuations in these securities are due to specific market conditions, which provide the Bank with funds and investment opportunities to generate net revenue.

The Bank had net assets of $157.5 million at June 30, 2012, an increase of $10.3 million or 7% when compared to June 30, 2011. Additional information about net assets composition is presented in note 11 to the basic financial statements.

Comparison of 2012 and 2011 Revenue, Expenses, and Changes in Net Assets

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

Revenue, expenses, and changes in net assets		2012	2011	Increase (decrease) Amount	Percentage
Interest income from loans	$	12,156	9,952	2,204	22.15%
Interest income from investments		55,389	44,310	11,079	25.00
Total interest income		67,545	54,262	13,283	24.48
Total noninterest income		1,537	17,506	(15,969)	(91.22)
Total operating revenue		69,082	71,768	(2,686)	(3.74)
Provision for loan losses		8,600	18,750	(10,150)	(54.13)
Total interest expense		46,443	38,843	7,600	19.57
Total noninterest expenses		12,414	12,450	(36)	(0.29)
Total operating expenses		67,457	70,043	(2,586)	(3.69)
Operating income		1,625	1,725	(100)	(5.80)
Capital contribution		8,710	474	8,236	1,737.55
Net income and change in net assets	$	10,335	2,199	8,136	369.99

For the year ended June 30, 2012, the Bank presents an operating income of $1.6 million when compared to the operating income of $1.7 million for the year ended June 30, 2011. The decrease in operating income resulted from the net effect of the following:

(a) Interest Income

Total interest income increased by approximately 24.5% or $13.3 million, from $54.2 million in 2011 to $67.5 million in 2012. This increase in interest income was mainly the result of increased average transaction volumes during the fiscal year, with basically no change in average interest rates.

(b) Noninterest Income

Noninterest income decreased by approximately $16 million, from $17.5 million in fiscal year 2011 to $1.5 million income in 2012. This decrease was mainly due to a decrease in the net realized and unrealized gains on investments of $15.7 million.

The decrease in the net realized and unrealized gains on investment results from the combined effect of a $8.9 million decrease in net unrealized gains of investment securities and a $6.8 million decrease in net realized gains from the disposition of investments.

(c) Provision for Loan Losses

Compared to 2011, the provision for loan losses shows a decrease of $10.2 million. This years' decrease when compared to 2011 reflects some relief on the commercial lending delinquency of prior years. Impaired loans requiring an allowance for losses decreased by $12.1 million, from $51.6 million in 2011 to $39.5 million in 2012, and the specific reserve for these decreased by $2.9 million, from $14.9 million to $12 million. As a percentage of the total loans portfolio, impaired loans represent 28.1% and 30.7% at June 30, 2012 and 2011, respectively. Loans charged off during fiscal year 2012 decreased by $10.4 million when compared to 2011, from $25.8 million in 2011 to $15.4 million in 2012. As a percentage of the total loans portfolio, the allowance for loan losses represents 11.5% and 13.4% at June 30, 2012 and 2011, respectively.

Loan collections increased from $98.4 million during fiscal year 2011 to $113.8 million for fiscal year 2012.

(d) Interest Expense

Total interest expense increased by 19.6% or $7.6 million, from $38.8 million in 2011 to $46.4 million in 2012. This increase in interest expense was the result of increased average principal balances owed.

(e) Noninterest Expenses

Noninterest expenses decreased by approximately $36,000 or 0.3% during fiscal year 2012. This decrease in noninterest expenses resulted from the net effect of the following:

- Salaries and employee benefits increased by 6.3% or $519,000, from approximately $8.2 million in 2011 to approximately $8.7 million in 2012. The increase is mainly due to an increase in other employee benefits.
- Provision for foreclosed assets decreased 25% or $250,000, from $1 million in 2011 to $750,000 in 2012.
- Professional fees decreased by 31.6% or $188,000, from approximately $594,000 in 2011 to approximately $406,000 in 2012. The decrease is mainly due to a decrease in other professional services during 2012, mainly appraisers of foreclosed and collateral real estate property.

- All other noninterest expenses decreased by approximately $117,000 as compared to fiscal year 2011. This is mainly due to the reversal of $250,000 from the provision for legal claims in 2012 when compared to no expense recorded in 2011. The legal reserve reversal relates to one specific claim which created the contingency for that amount in 2010, and which at June 30, 2012 is deemed unwarranted. On other reasons for the variance, there was an increase of $120,000 in advertising, an increase of $47,000 in other miscellaneous expenses and a decrease of $34,000 in occupancy and related expense (including depreciation).

Comparison of 2011 and 2010 Assets, Liabilities, and Net Assets

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

Net assets		2011	2010	Increase (decrease) Amount	Increase (decrease) Percentage
Current assets	$	415,581	267,152	148,429	55.56%
Noncurrent assets		963,453	928,039	35,414	3.82
Total assets	$	1,379,034	1,195,191	183,843	15.38
Current liabilities	$	551,165	455,911	95,254	20.89
Noncurrent liabilities		680,691	594,301	86,390	14.54
Total liabilities		1,231,856	1,050,212	181,644	17.30
Net assets:					
Invested in capital assets, net of related debt		(935)	(1,239)	304	24.54
Restricted for special loan programs		8,449	8,889	(440)	(4.95)
Unrestricted		139,664	137,329	2,335	1.70
		147,178	144,979	2,199	1.52
Total liabilities and net assets	$	1,379,034	1,195,191	183,843	15.38

At June 30, 2011, the Bank's total assets were $1,379 million ($323.4 million from EDBCI) compared to $1,195.2 million at June 30, 2010 ($314.4 million from EDBCI). The increase of $183.8 million represents 15.4% of the 2010 total assets balance.

Total loan portfolio decreased by 0.3% when compared to balances as of June 30, 2010. Loan disbursements increased from $85.1 million in 2010 to $123.5 million in 2011, while principal collected on loans increased from $67.3 million for fiscal year 2010 to $98.5 million for fiscal year 2011. The related allowance for loan losses decreased by $5.4 million or 13.7% of the 2010 balance, mainly due to an increase of $2.6 million in loans charged-off during the period, from $23.3 million in 2010 to $25.8 million in 2011. The net loan portfolio increased by $4.6 million.

Interest-bearing deposits with other banks, commercial paper, investments, and securities purchased under agreements to resell increased by $176.2 million when compared to balances as of June 30, 2010, mainly due to the issuance of $151.1 million in promissory notes.

At June 30, 2011, the Bank's total liabilities were $1,231.9 million compared to $1,050.2 million at June 30, 2010. The increase of $181.7 million represents 17.3% of the 2010 total liabilities. This increase is mainly due to a $151.1 million net increase in promissory notes.

Total time deposits were $454.6 million as of June 30, 2011. Time deposits consist primarily of certificates of deposit of public funds from other governmental institutions, which totaled $346.4 million. Deposits from other financial institutions were $108.2 million. Total time deposits increased by $69.3 million. As of year-end, the total promissory notes and other note payable balance was $618.2 million.

Securities sold under agreement to repurchase decreased by $40.4 million, from $177.8 million in 2010 to $137.4 million in 2011. Fluctuations in these securities are due to specific market conditions, which provide the Bank with funds and investment opportunities to generate net revenue.

The Bank had net assets of $147.2 million at June 30, 2011, an increase of $2.2 million or 1.5% when compared to June 30, 2010. Additional information about net assets composition is presented in note 11 to the basic financial statements.

Comparison of 2011 and 2010 Revenue, Expenses, and Changes in Net Assets

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

Revenue, expenses, and changes in net assets	2011	2010	Increase (decrease) Amount	Increase (decrease) Percentage
Interest income from loans	$ 9,952	11,673	(1,721)	(14.74)%
Interest income from investments	44,310	37,623	6,687	17.77
Total interest income	54,262	49,296	4,966	10.07
Total noninterest income	17,506	4,679	12,827	274.14
Total operating revenue	71,768	53,975	17,793	32.97
Provision for loan losses	18,750	13,485	5,265	39.04
Total interest expense	38,843	26,741	12,102	45.26
Total noninterest expenses	12,450	11,830	620	5.24
Total operating expenses	70,043	52,056	17,987	34.55
Operating income	1,725	1,919	(194)	(10.11)
Capital contribution	474	30,000	(29,526)	(98.42)
Net income and change in net assets	$ 2,199	31,919	(29,720)	(93.11)

For the year ended June 30, 2011, the Bank presents an operating income of $1.7 million when compared to the operating income of $1.9 million for the year ended June 30, 2010. The decrease in operating income resulted from the net effect of the following:

(a) Interest Income

Total interest income increased by approximately 10.1% or $5 million, from $49.3 million in 2010 to $54.3 million in 2011. This increase in interest income was mainly the result of increased average transaction volumes net of decreased average interest rates during the fiscal year. The decrease in average interest rates is due to the redemption by the issuer of $75 million floating rate notes due on September 12, 2011 and with an interest rate of 10.3%. This redemption resulted in a gain on investments of approximately $7.7 million, and at the same time reduced the yield of the investments portfolio by approximately 1%.

(b) Noninterest Income

Noninterest income increased by approximately $12.8 million, from $4.7 million in fiscal year 2010 to $17.5 million income in 2011. This increase was mainly due to an increase in the net realized and unrealized gains on investments of $12.7 million.

The increase in the net realized and unrealized gains on investment results from the combined effect of a $3.2 million increase in net unrealized gains of investment securities, a $6.7 million gain on sale of corporate notes and a $2.9 million decrease in net realized losses from the disposition of investments.

(c) Provision for Loan Losses

Compared to 2010, the provision for loan losses shows an increase of $5.3 million. This change is mainly due to the continued deterioration of the local economy during last year. Impaired loans requiring an allowance for losses increased by $13.5 million, from $38.1 million in 2010 to $51.6 million in 2011, and the specific reserve for these increased by $282,000, from $14.7 million to $14.9 million. As a percentage of the total loans portfolio, impaired loans represent 30.7% and 28.9% at June 30, 2011 and 2010, respectively. Loans charged off during fiscal year 2011 increased by $2.5 million when compared to 2010, from $23.3 million in 2010 to $25.8 million in 2011. As a percentage of the total loans portfolio, the allowance for loan losses represents 13.4% and 15.5% at June 30, 2012 and 2011, respectively.

Loan collections increased from $67.3 million during fiscal year 2010 to $98.4 million for fiscal year 2011.

(d) Interest Expense

Total interest expense increased by 45.3% or $12 million, from $26.8 million in 2010 to $38.8 million in 2011. This increase in interest expense was the result of increased average principal balances owed.

(e) Noninterest Expenses

Noninterest expenses increased by approximately $620,000 or 5.2% during fiscal year 2011. This increase in noninterest expenses resulted from the net effect of the following:

- Provision for foreclosed assets increased 233.3% or $700,000, from $300,000 in 2010 to $1 million in 2011. This increase is mainly due to foreclosed real estate value decline reflected in recent appraisals.
- Professional fees increased by 50.9% or $200,000, from approximately $394,000 in 2010 to approximately $594,000 in 2011. The increase is mainly due to an increase in other professional services during 2011, mainly appraisers of foreclosed and collateral real estate property.
- Salaries and employee benefits decreased by 2.4% or $198,000, from approximately $8.4 million in 2010 to approximately $8.2 million in 2011. The decrease is mainly due to a reduction in headcount.
- All other noninterest expenses decreased by approximately $82,000 as compared to fiscal year 2010. This is due to the absence of a provision for legal claims in 2011 when compared to a $300,000 expense recorded in 2010. In addition, there was an increase of approximately $233,000 in other miscellaneous expenses, a decrease of $27,000 in occupancy and related expense (including depreciation) and an increase of $12,000 in advertising.

Analysis of the Overall Financial Position and Results of Operations

The average balance of funds available from deposits and the related investments reflect an increase when comparing 2012 to 2011, mainly due to the issuance of $170 million in promissory notes. When compared with fiscal year 2011, time deposits balances from other governmental and financial institutions increased 19.6% or $89 million in 2012, thus providing adequate levels of funding to maintain the Bank's activities. Interest rates during fiscal years 2012 and 2011 remained low.

During the fiscal years 2012 and 2011, $5.4 million were recovered in previously charged off loans.

Discussion of Significant Capital Assets and Long-Term Debt Activity

During fiscal year 2012, approximately $187,000 in capital assets was acquired and approximately $153,000 was retired. During the same period, $170 million in promissory notes were issued, and $51.7 million matured or amortized. As of year-end, the total promissory notes and other note payable balance was $736 million. Additional information about capital assets and long-term debt activity is presented in notes 5 and 9 to the basic financial statements, respectively.

Contacting the Bank's Financial Management

This financial report is designed to provide a general overview of the Bank'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 Economic Development Bank for Puerto Rico, P.O. Box 2134, San Juan, PR 00922-2134.

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

Statement of Net Assets – Business-Type Activities

June 30, 2012

Assets	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Current assets:				
Cash and due from banks	$ 5,479,989	—	—	5,479,989
Interest-bearing deposits and commercial paper	121,500,000	12,041,891	(12,041,891)	121,500,000
Securities purchased under agreements to resell	62,251,000	—	—	62,251,000
Investments	34,143,020	41,800,000	—	75,943,020
Loans, net of allowance for loan losses of $11,239,314	103,577,891	—	—	103,577,891
Accrued interest receivable	8,779,320	578,869	(585)	9,357,604
Due from other fund	—	659	(659)	—
	335,731,220	54,421,419	(12,043,135)	378,109,504
Noncurrent assets:				
Investments	780,537,003	268,721,175	—	1,049,258,178
Loans, net of allowance for loan losses of $19,761,372	136,094,749	—	—	136,094,749
Other assets	6,444,874	—	—	6,444,874
Capital assets:				
Land	2,735,000	—	—	2,735,000
Building and improvements	11,281,593	—	—	11,281,593
Furniture and equipment	4,933,199	—	—	4,933,199
Less accumulated depreciation and amortization	(9,766,951)	—	—	(9,766,951)
Total capital assets	9,182,841	—	—	9,182,841
	932,259,467	268,721,175	—	1,200,980,642
Total assets	$ 1,267,990,687	323,142,594	(12,043,135)	1,579,090,146
Liabilities and Net Assets				
Current liabilities:				
Time deposits	$ 555,655,854	—	(12,041,891)	543,613,963
Securities sold under agreements to repurchase	104,925,000	—	—	104,925,000
Accrued interest payable	6,384,699	517,271	(585)	6,901,385
Promissory notes and other note payable	470,741	41,800,000	—	42,270,741
Due to other fund	659	—	(659)	—
Other current liabilities	3,060,118	7,395	—	3,067,513
	670,497,071	42,324,666	(12,043,135)	700,778,602
Noncurrent liabilities:				
Securities sold under agreements to repurchase	19,000,000	—	—	19,000,000
Promissory notes and other note payable	460,562,743	233,200,000	—	693,762,743
Other liabilities	8,027,887	7,551	—	8,035,438
	487,590,630	233,207,551	—	720,798,181
Total liabilities	1,158,087,701	275,532,217	(12,043,135)	1,421,576,783
Net assets:				
Invested in capital assets, net of related debt	(709,805)	—	—	(709,805)
Restricted for special loan programs	13,157,869	—	—	13,157,869
Unrestricted	97,454,922	47,610,377	—	145,065,299
Total net assets	109,902,986	47,610,377	—	157,513,363
Commitments and contingencies				
Total liabilities and net assets	$ 1,267,990,687	323,142,594	(12,043,135)	1,579,090,146

See accompanying notes to basic financial statements.

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

Statement of Revenue, Expenses, and Changes in Net Assets – Business-Type Activities

Year ended June 30, 2012

		EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Operating revenue:					
Interest income:					
Deposits with other banks and commercial paper	$	718,319	39,438	(39,438)	718,319
Securities purchased under agreements to resell		1,830,126	—	—	1,830,126
Investments		32,001,954	20,838,324	—	52,840,278
Loans		12,156,268	—	—	12,156,268
Total interest income		46,706,667	20,877,762	(39,438)	67,544,991
Noninterest income:					
Net realized and unrealized gains (losses) on investments		2,032,735	(1,385,733)	—	647,002
Other income		937,226	—	(47,092)	890,134
Total noninterest income		2,969,961	(1,385,733)	(47,092)	1,537,136
Total operating revenue		49,676,628	19,492,029	(86,530)	69,082,127
Operating expenses:					
Provision for loan losses		8,600,000	—	—	8,600,000
Interest expense:					
Time deposits		3,062,767	—	(39,438)	3,023,329
Securities sold under agreements to repurchase		2,972,975	—	—	2,972,975
Promissory notes and other note payable		21,786,728	18,659,950	—	40,446,678
Total interest expense		27,822,470	18,659,950	(39,438)	46,442,982
Noninterest expenses:					
Salaries and employee benefits		8,607,140	95,344	—	8,702,484
Depreciation and amortization		406,163	—	—	406,163
Occupancy and related expenses		306,410	—	—	306,410
Professional fees		406,536	47,092	(47,092)	406,536
Advertising		446,885	—	—	446,885
Other		2,145,207	528	—	2,145,735
Total noninterest expenses		12,318,341	142,964	(47,092)	12,414,213
Total operating expenses		48,740,811	18,802,914	(86,530)	67,457,195
Operating income		935,817	689,115	—	1,624,932
Capital contribution		8,710,304	—	—	8,710,304
Increase in net assets		9,646,121	689,115	—	10,335,236
Total net assets, beginning of year		100,256,865	46,921,262	—	147,178,127
Total net assets, end of year	$	109,902,986	47,610,377	—	157,513,363

See accompanying notes to basic financial statements.

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

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2012

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Cash flows from operating activities:				
Cash payments for goods and services	$ (2,791,045)	(47,620)	—	(2,838,665)
Cash payments to employees	(8,452,041)	(95,236)	—	(8,547,277)
Cash received from interest and principal on loans	126,568,515	—	—	126,568,515
Other payments	(2,076,769)	(446,386)	—	(2,523,155)
Cash disbursed for loaned amounts	(145,171,959)	—	—	(145,171,959)
Net cash used in operating activities	(31,923,299)	(589,242)	—	(32,512,541)
Cash flows from noncapital financing activities:				
Net increase (decrease) in:				
Time deposits	90,322,187	—	(1,328,176)	88,994,011
Securities sold under agreements to repurchase	(13,475,000)	—	—	(13,475,000)
Issuance of promissory notes	170,715,892	—	—	170,715,892
Repayment of promissory notes	(52,392,147)	—	—	(52,392,147)
Interest paid on time deposits, securities sold under agreements to repurchase, and promissory notes	(25,863,692)	(19,147,673)	40,717	(44,970,648)
Net cash provided by (used in) noncapital financing activities	169,307,240	(19,147,673)	(1,287,459)	148,872,108
Cash flows from capital and related financing activities:				
Capital contribution	8,710,304	—	—	8,710,304
Acquisition of capital assets	(187,259)	—	—	(187,259)
Principal payment on capital debt	(444,095)	—	—	(444,095)
Interest paid on capital debt	(620,204)	—	—	(620,204)
Net cash provided by capital and related financing activities	7,458,746	—	—	7,458,746
Cash flows from investing activities:				
Acquisition of investments	(749,827,379)	(1,728,571)	—	(751,555,950)
Principal repayments and maturities of investments	444,557,467	1,350,000	—	445,907,467
Net decrease (increase) in:				
Interest-bearing deposits with other banks	(91,398,062)	(1,328,176)	1,328,176	(91,398,062)
Securities purchased under agreements to resell	218,770,000	—	—	218,770,000
Interest collected on investments, notes receivable, interest-bearing deposits with other banks, and commercial paper	31,976,422	21,443,662	(40,717)	53,379,367
Proceeds from sales of foreclosed assets	96,083	—	—	96,083
Net cash provided by (used in) investing activities	(145,825,469)	19,736,915	1,287,459	(124,801,095)
Net decrease in cash and due from banks	(982,782)	—	—	(982,782)
Cash and due from banks, beginning of year	6,462,771	—	—	6,462,771
Cash and due from banks, end of year	$ 5,479,989	—	—	5,479,989

(Continued)

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

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2012

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Reconciliation of operating income to net cash used in operating activities:				
Operating income	$ 935,817	689,115	—	1,624,932
Adjustments to reconcile operating income to net cash used in operating activities:				
Depreciation and amortization	406,163	—	—	406,163
Net realized and unrealized gain (loss) on investments	(2,032,735)	1,421,733	—	(611,002)
Provision for loan losses	8,600,000	—	—	8,600,000
Provision for losses on foreclosed assets	750,000	—	—	750,000
Gain on sale of foreclosed assets	(31,750)	—	—	(31,750)
Interest income from investments	(34,550,399)	(20,877,762)	39,438	(55,388,723)
Decrease in accrued interest receivable from loans	(128,858)	—	—	(128,858)
Interest expense	27,822,470	18,659,950	(39,438)	46,442,982
Decrease (increase) in other assets	1,466,813	(482,386)	—	984,427
Increase in loans receivable	(30,630,854)	—	—	(30,630,854)
(Increase) decrease in other liabilities	(4,529,966)	108	—	(4,529,858)
Net cash used in operating activities	$ (31,923,299)	(589,242)	—	(32,512,541)
Supplemental cash flow information and noncash transactions:				
Increase (decrease) in fair value of investments	$ 2,201,705	(1,421,733)	—	779,972
Transfer from loans to foreclosed real estate	3,258,947	—	—	3,258,947
Retirement of fully depreciated capital assets	153,260	—	—	153,260

See accompanying notes to basic financial statements.

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

Statement of Net Assets – Business-Type Activities

June 30, 2011

Assets	**EDB Operating Fund**	**EDB Capital Investment**	**Eliminations**	**Total**
Current assets:				
Cash and due from banks	$ 6,462,771	—	—	6,462,771
Interest-bearing deposits and commercial paper	30,101,938	10,713,715	(10,713,715)	30,101,938
Securities purchased under agreements to resell	281,021,000	—	—	281,021,000
Investments	2,000,000	—	—	2,000,000
Loans, net of allowance for loan losses of $11,603,490	88,776,040	—	—	88,776,040
Accrued interest receivable	6,076,485	1,144,770	(1,864)	7,219,391
Due from other fund	481,727	—	(481,727)	—
	414,919,961	11,858,485	(11,197,306)	415,581,140
Noncurrent assets:				
Investments	505,377,377	311,564,337	—	816,941,714
Loans, net of allowance for loan losses of $22,531,283	131,549,284	—	—	131,549,284
Other assets	5,560,095	—	—	5,560,095
Capital assets:				
Land	2,735,000	—	—	2,735,000
Building and improvements	11,143,249	—	—	11,143,249
Furniture and equipment	5,037,544	—	—	5,037,544
Less accumulated depreciation and amortization	(9,514,048)	—	—	(9,514,048)
Total capital assets	9,401,745	—	—	9,401,745
	651,888,501	311,564,337	—	963,452,838
Total assets	$ 1,066,808,462	323,422,822	(11,197,306)	1,379,033,978
Liabilities and Net Assets				
Current liabilities:				
Time deposits	$ 465,333,667	—	(10,713,715)	454,619,952
Securities sold under agreements to repurchase	86,600,000	—	—	86,600,000
Accrued interest payable	5,046,126	1,004,995	(1,864)	6,049,257
Promissory notes and other note payable	444,095	—	—	444,095
Due to other fund	—	481,727	(481,727)	—
Other current liabilities	3,446,620	4,888	—	3,451,508
	560,870,508	1,491,610	(11,197,306)	551,164,812
Noncurrent liabilities:				
Securities sold under agreements to repurchase	50,800,000	—	—	50,800,000
Promissory notes and other note payable	342,709,739	275,000,000	—	617,709,739
Other liabilities	12,171,350	9,950	—	12,181,300
	405,681,089	275,009,950	—	680,691,039
Total liabilities	966,551,597	276,501,560	(11,197,306)	1,231,855,851
Net assets:				
Invested in capital assets, net of related debt	(934,996)	—	—	(934,996)
Restricted for special loan programs	8,449,093	—	—	8,449,093
Unrestricted	92,742,768	46,921,262	—	139,664,030
Total net assets	100,256,865	46,921,262	—	147,178,127
Commitments and contingencies				
Total liabilities and net assets	$ 1,066,808,462	323,422,822	(11,197,306)	1,379,033,978

See accompanying notes to basic financial statements.

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

Statement of Revenue, Expenses, and Changes in Net Assets – Business-Type Activities

Year ended June 30, 2011

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Operating revenue:				
Interest income:				
Deposits with other banks and commercial paper	$ 549,596	26,280	(26,280)	549,596
Securities purchased under agreements to resell	2,831,679	—	—	2,831,679
Investments	21,887,008	19,041,051	—	40,928,059
Loans	9,952,385	—	—	9,952,385
Total interest income	35,220,668	19,067,331	(26,280)	54,261,719
Noninterest income:				
Net realized and unrealized gains on investments	8,188,611	8,191,327	—	16,379,938
Other income	1,176,943	—	(50,455)	1,126,488
Total noninterest income	9,365,554	8,191,327	(50,455)	17,506,426
Total operating revenue	44,586,222	27,258,658	(76,735)	71,768,145
Operating expenses:				
Provision for loan losses	18,750,000	—	—	18,750,000
Interest expense:				
Time deposits	3,005,607	—	(26,280)	2,979,327
Securities sold under agreements to repurchase	3,569,190	—	—	3,569,190
Promissory notes and other note payable	15,082,983	17,211,588	—	32,294,571
Total interest expense	21,657,780	17,211,588	(26,280)	38,843,088
Noninterest expenses:				
Salaries and employee benefits	8,090,633	92,965	—	8,183,598
Depreciation and amortization	409,039	—	—	409,039
Occupancy and related expenses	337,164	—	—	337,164
Professional fees	594,420	50,455	(50,455)	594,420
Advertising	326,911	—	—	326,911
Other	2,596,915	2,083	—	2,598,998
Total noninterest expenses	12,355,082	145,503	(50,455)	12,450,130
Total operating expenses	52,762,862	17,357,091	(76,735)	70,043,218
Operating income (loss)	(8,176,640)	9,901,567	—	1,724,927
Capital contribution	473,902	—	—	473,902
Increase (decrease) in net assets	(7,702,738)	9,901,567	—	2,198,829
Total net assets, beginning of year	107,959,603	37,019,695	—	144,979,298
Total net assets, end of year	$ 100,256,865	46,921,262	—	147,178,127

See accompanying notes to basic financial statements.

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

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2011

	EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Cash flows from operating activities:				
Cash payments for goods and services	$ (2,782,117)	(52,538)	—	(2,834,655)
Cash payments to employees	(8,434,680)	(103,304)	—	(8,537,984)
Cash received from interest and principal on loans	109,847,931	—	—	109,847,931
Other receipts (payments)	1,167,293	(1,322,658)	—	(155,365)
Cash disbursed for loaned amounts	(123,523,045)	—	—	(123,523,045)
Net cash used in operating activities	(23,724,618)	(1,478,500)	—	(25,203,118)
Cash flows from noncapital financing activities:				
Net increase (decrease) in:				
Time deposits	78,439,323	—	(9,097,883)	69,341,440
Securities sold under agreements to repurchase	(40,350,000)	—	—	(40,350,000)
Issuance of promissory notes	153,104,587	—	—	153,104,587
Repayment of promissory notes	(1,608,309)	—	—	(1,608,309)
Interest paid on time deposits, securities sold under agreements to repurchase, and promissory notes	(17,955,542)	(16,680,204)	24,794	(34,610,952)
Net cash provided by (used in) noncapital financing activities	171,630,059	(16,680,204)	(9,073,089)	145,876,766
Cash flows from capital and related financing activities:				
Capital contribution	473,902	—	—	473,902
Acquisition of capital assets	(294,104)	—	—	(294,104)
Principal payment on capital debt	(418,958)	—	—	(418,958)
Interest paid on capital debt	(645,342)	—	—	(645,342)
Net cash used in capital and related financing activities	(884,502)	—	—	(884,502)
Cash flows from investing activities:				
Acquisition of investments	(309,963,361)	(2,685,000)	—	(312,648,361)
Principal repayments and maturities of investments	284,714,547	11,495,385	—	296,209,932
Net decrease (increase) in:				
Interest-bearing deposits with other banks	(30,101,938)	(9,097,883)	9,097,883	(30,101,938)
Securities purchased under agreements to resell	(113,366,000)	—	—	(113,366,000)
Interest collected on investments, notes receivable, interest-bearing deposits with other banks, and commercial paper	23,754,549	18,446,202	(24,794)	42,175,957
Proceeds from sales of foreclosed assets	822,364	—	—	822,364
Net cash provided by (used in) investing activities	(144,139,839)	18,158,704	9,073,089	(116,908,046)
Net increase in cash and due from banks	2,881,100	—	—	2,881,100
Cash and due from banks, beginning of year	3,581,671	—	—	3,581,671
Cash and due from banks, end of year	$ 6,462,771	—	—	6,462,771

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

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2011

		EDB Operating Fund	EDB Capital Investment	Eliminations	Total
Reconciliation of operating income (loss) to net cash used in operating activities:					
Operating income (loss)	$	(8,176,640)	9,901,567	—	1,724,927
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization		409,039	—	—	409,039
Net realized and unrealized gains on investments		(8,188,611)	(8,122,327)	—	(16,310,938)
Provision for loan losses		18,750,000	—	—	18,750,000
Provision for losses on foreclosed assets		1,000,000	—	—	1,000,000
Gain on sale of foreclosed assets		(216,359)	—	—	(216,359)
Interest income from investments		(25,268,283)	(19,067,330)	26,280	(44,309,333)
Decrease in accrued interest receivable from loans		(3,678)	—	—	(3,678)
Interest expense		21,657,780	17,211,588	(26,280)	38,843,088
Decrease (increase) in other assets		1,937,063	(1,391,658)	—	545,405
Increase in loans receivable		(23,623,821)	—	—	(23,623,821)
Increase in other liabilities		(2,001,108)	(10,340)	—	(2,011,448)
Net cash used in operating activities	$	(23,724,618)	(1,478,500)	—	(25,203,118)
Supplemental cash flow information and noncash transactions:					
Increase in fair value of investments	$	1,511,311	8,122,327	—	9,633,638
Transfer from loans to foreclosed real estate		233,760	—	—	233,760
Retirement of fully depreciated capital assets		156,975	—	—	156,975

See accompanying notes to basic financial statements.

(1) Organization and Summary of Significant Accounting Policies

Economic Development Bank for Puerto Rico (the Bank) was created by the Puerto Rico Development Bank Act No. 22 of July 24, 1985, as amended, and constitutes a public corporation of the Commonwealth of Puerto Rico (the Commonwealth). The Bank is a component unit included in the Commonwealth's financial reporting entity and is a separate legal entity. The Bank promotes the development of the private sector of the economy of Puerto Rico. This is accomplished by making direct loans, loan guarantees, loan participations, and/or direct investments available to any person or business organization devoted to manufacturing, agriculture, trade, tourism, or other service enterprises, whose economic activity may have the effect of substituting imports, without this being understood as a limitation.

The Bank's operation consists principally in granting commercial loans and capital investments to small businesses, receiving deposits from other governmental or commercial financial institutions, issuing notes and other debts, and investing in securities and other financial instruments, similar to a private commercial bank. All revenue, such as interest, gains, dividends, and fees related to these activities, are presented as operating income. All expenses related to these revenue activities, such as interest expense, provision for losses, and administrative expenses, are considered operating expenses. For financial statements presentation, operating revenue is segregated between interest income and noninterest income, and operating expenses between interest expense, provision for losses, and other noninterest expenses.

The Bank is not required to pay any taxes on any assets acquired or to be acquired for its operations or activities, or on the revenue received from any of its operations or activities.

In 2006, the Bank's board of directors created a component unit named Economic Development Bank Capital Investment (EDBCI). EDBCI is a blended component unit of the Bank, which is presented as a business-type activity. The balances and transactions of EDBCI have been blended with the Bank in accordance with U.S. generally accepted accounting principles (GAAP) because, though legally separated, it was created and can be dissolved through resolutions of the Bank's board of directors. The board of directors of EDBCI is the same as that of the Bank. EDBCI operation consists only of supporting the Bank's mission in promoting the development of the private sector of the economy of Puerto Rico, investing in equity and other forms of capital of start-up, early, or later stage local enterprises or venture capital funds. During fiscal year 2007, the Bank transferred its capital investment portfolio, amounting to $27,445,966, as initial capital to EDBCI. An additional $30 million was approved for new capital investments as deemed necessary in EDBCI investment activity. Also, EDBCI was authorized to invest in corporate paper as part of a new notes payable program like the one described in note 9.

The accounting policies followed by the Bank are in accordance with GAAP, as applicable to governmental entities. The business-type activities of the Bank are accounted for as an enterprise fund. Accordingly, the Bank follows the accrual basis of accounting and the economic resources measurement focus. Revenue is recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid. The following is a description of the most significant accounting policies:

(a) Use of Estimates

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 disclosure 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. Significant estimates made by management include the allowance for loan losses, losses on foreclosed assets, losses on loan guarantees, and venture capital investments; the useful lives of fixed assets; the valuation of fixed assets and investments; and accruals for legal claims and other contingencies. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

(b) Basis of Presentation

Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Bank is required to apply all applicable GASB pronouncements as well as statements and interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions (APB), and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure issued on or before November 30, 1989. In addition to applying FASB Statements and Interpretations, APB Opinions, and ARBs issued on or before November 30, 1989, a proprietary activity may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. The Bank has elected to also apply FASB Statements and Interpretations issued after November 30, 1989.

(c) Securities Purchased under Agreements to Resell

The Bank enters into purchases of securities under agreements to resell, as authorized by Act number 22 of July 24, 1985, Article 3. The amounts advanced under these agreements are reflected as an asset in the accompanying statements of net assets. The securities underlying these agreements, mainly interest-bearing deposits with other banks and government securities, are held under safekeeping by a financial institution independent of the transaction.

(d) Investments

The Bank follows GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This Statement establishes accounting and financial reporting standards for all investments held by governmental external investment pools. For most other governmental entities, it requires that most investments be reported at fair value in the statements of net assets.

The governing board authorizes the Bank to invest in the following:

- U.S. government and agencies obligations
- Obligations of the Commonwealth, its agencies, municipalities, public corporations, and instrumentalities
- Certificates and time deposits
- Commercial paper
- Bankers' acceptance
- Federal funds
- Securities purchased under agreements to resell
- Mortgage- and asset-backed securities
- Corporate notes
- External investment pools

The Bank's investment policies also establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories. Such policies provide the requirements in the institutions with which investment transactions can be entered into. In addition to the Assets, Liabilities, and Investments Committee (ALCO), the Board of Directors of the Bank may approve, as necessary, other transactions that the Bank may enter into.

Investments in debt securities are presented at fair value, including the effect of applicable put options as described in note 9. Money market investments and participating interest-earning investment contracts with a remaining maturity at time of purchase of one year or less are presented at amortized cost. Changes in the fair value of investments are presented in net realized and unrealized gains (losses) on investments in the statements of revenue, expenses, and changes in net assets. Fair value is determined based on quoted market prices.

Investments also include common and preferred stocks of various local enterprises that do not have readily determinable fair value and investment positions in external investment pools. The investments in common and preferred stocks are temporary and the Bank generally does not have the ability to exercise significant influence over the investees' operating and financial policies, and therefore, such investments are carried at the lower of cost or net realizable value based on management's evaluation of the financial condition of each investee. Because of uncertainties inherent in the estimation process, management's evaluation of the financial condition of the investees, and the related assessment of net realizable value may change in the near term.

Investment positions in external investment pools are reported at the net asset value of the shares held by the Bank. Such net asset value represents the fair value per share of the pools' underlying net assets. The financial statements of these pools include securities whose fair values have been estimated by the pools' managers in the absence of readily ascertainable market values. The Bank's external investment pools that are not registered with the Securities and Exchange Commission are supervised by the Commissioner of Financial Institutions, which is the governmental agency that regulates venture capital funds and the banking industry in Puerto Rico.

(e) Loans

Loans are presented at the unpaid principal balance reduced by the allowance for loan losses, and any deferred fees or costs on originated loans. In accordance with the Bank's charge-off policy approved on February 2012, unsecured loans are charged off against the allowance for loans losses within 60 days after they have payments due over 120 days. For collateralized loans, charge-offs are recognized for the amount of collateral deficiency within 60 days after they have payments due over 180 days. Although one of the factors evaluated by management in making this assessment is the number of days past due, the policy also allows the Bank to charge-off loans when special circumstances arise and upon the approval of the corresponding level of authority.

Recoveries of loans previously charged off are credited to the allowance for loan losses.

The accrual of interest on loans ceases when loans become past due 90 days or more and/or on those loans undergoing judicial or bankruptcy proceedings. Once a loan is placed on nonaccrual status, all accrued but uncollected interest is reversed from interest income. Interest on all nonaccrual loans is thereafter included in earnings only to the extent actually collected. Loans designated as nonaccruing are not returned to an accrual status until interest is received on a current basis and those factors indicative of doubtful collection cease to exist.

Beginning July 1, 2010, collections received for nonaccrual loans are applied, for financial statement purposes, to principal owed. The change in payment application for nonaccrual loans is intended to reduce the recorded exposure to losses as well as the related required levels of the allowance for losses. Delinquency history and collection efforts are monitored in accordance to the full accrual amortization schedule of the loan.

The allowance for loan losses is maintained at a level believed adequate by management to absorb potential losses in the loan portfolio. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, past loan loss experience, economic conditions, volume growth, composition of the loan portfolio, and other relevant factors. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio, and the related allowance may change in the near term.

During 2011, the Bank updated the computation of loss factors used in the establishment of the allowance for loan losses under the Accounting Standards Codification (ASC) 450-10-05-05, *Contingencies* (previously referred to as SFAS No. 5). The general reserve is estimated using historical loan loss factors, adjusted for current environmental factors, by segregating the loan portfolio in the three major segments (i.e. commercial, agricultural and other small commercial loans). For each segment, the loss factors were estimated by delinquency categories; before 2011, loss factors were judgmentally determined based on the overall experience of the Bank.

(f) Classification of Loans and Allowance for Loan Losses

The current portion of loans includes the active principal of loans with maturities of one year or less and past due over three months and/or those loans undergoing judicial or bankruptcy proceedings. Also, these include the estimated current portion of loans with maturity over one year. The resulting difference was reported as the noncurrent portion.

The allowance for loan losses was allocated between current and noncurrent proportionally based on the loan classification.

(g) Loan Guarantee Program

Guarantee fees on the loan guarantee program are recognized as income when the fees are collected. Such fees are estimated not to exceed related guarantee expenses. The accrual for losses on loan guarantees is based on management's evaluation of the potential loss on each guarantee, net of amounts recoverable from collateral and the share of loss of the participating banks, and is included in other liabilities. Because of uncertainties inherent in the estimation process, management's estimate of the provision for losses on loan guarantees, and the related accrual for losses on loan guarantees may change in the near term.

(h) Loan Origination Costs and Commitment Fees

The Bank defers loan origination and commitment fees and direct origination costs. The net amount is amortized over the contractual life of the related loan as a yield adjustment.

(i) Real Estate Owned

Real estate owned acquired in satisfaction of loans is included in other assets and is held for sale. Properties acquired through foreclosure are transferred to real estate owned and recognized at the lower of fair value minus estimated costs to sell or loan's carrying value, establishing a new cost basis. Subsequent declines in the value of real estate owned are provided for when it is probable the cost will not be recovered and that a loss will be incurred. An allowance for losses on real estate owned is maintained for subsequent valuation adjustments on a specific property basis.

(j) Capital Assets

Capital assets are defined by the Bank as assets with an individual initial cost of over $500 and expected useful lives of over one year. Capital assets are stated at cost, less accumulated depreciation and amortization. Depreciation is computed on the straight-line basis over the estimated useful lives of the depreciable assets, which have been determined to be 3 years for computer software, 5 years for all furniture and equipment, and 40 years for building and improvements. Expenditures for major improvements that extend the useful life of the asset are capitalized. Maintenance and repairs are charged to expense.

(k) Securities Sold under Agreements to Repurchase

The Bank enters into sales of securities under agreements to repurchase, as authorized by Act number 22 of July 24, 1985, Article 3. These agreements are presented as a liability in the accompanying statements of net assets. The securities underlying these agreements are usually held by the broker or its agent, with whom the agreement is transacted.

(l) Accounting for Compensated Absences

Compensated absences, such as unpaid vacation and sick leave pay, are accrued when incurred using the pay or salary rates in effect at the statement of net assets date. An additional amount is accrued for certain salary related benefits associated with the payment of compensated absences. Such amounts are included in other liabilities an the accompanying financial statements.

(m) Statements of Cash Flows

The accompanying statements of cash flows are presented in accordance with the provisions of GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. For purposes of reporting cash flows, cash includes cash on hand, amounts due from banks, and items in process of collection.

(2) Cash and Due from Banks, Interest-Bearing Deposits with Other Banks and Commercial Paper, and Securities Purchased under Agreements to Resell

As of June 30, 2012 and 2011, the carrying amount and the corresponding depository bank balances of cash and due from banks and interest-bearing deposits with other banks were as follows:

	2012	
	Carrying amount	**Depository bank balance**
Cash and due from banks	$ 5,479,989	5,391,495
Interest bearing deposits with other banks	121,500,000	121,500,000
	$ 126,979,989	126,891,495

		2011	
		Carrying amount	**Depository bank balance**
Cash and due from banks	$	6,462,771	4,161,639
Interest bearing deposits with other banks		30,101,938	30,101,938
	$	36,564,709	34,263,577

As of June 30, 2012 and 2011, the total depository bank balance consisted of $125,310,757 and $33,206,723, respectively, which was insured or collateralized with securities held by the Department of the Treasury of the Commonwealth and $1,580,738 and $1,056,854, respectively, deposited with the Government Development Bank for Puerto Rico (GDB), another component unit of the Commonwealth. Deposits with GDB are uninsured and uncollateralized.

The Bank's investment policies allow management to purchase commercial paper. The following table summarizes certain information about these purchases for the year ended June 30, 2012 and 2011:

		2012
Carrying amount at June 30	$	—
Average amount outstanding during the year		35,156,000
Maximum amount outstanding at any month-end		115,750,000
Weighted average interest rate for the year		0.66%

		2011
Carrying amount at June 30	$	—
Average amount outstanding during the year		6,583,000
Maximum amount outstanding at any month-end		79,000,000
Weighted average interest rate for the year		0.28%

The Bank's investment policies, as authorized by Act number 22 of July 24, 1985, Article 3, allow management to purchase securities under agreements to resell. The following table summarizes certain information about these agreements:

		2012	2011
Carrying amount at June 30	$	62,251,000	281,021,000
Average amount outstanding during the year		215,814,000	342,263,000
Maximum amount outstanding at any month-end		331,183,000	431,259,000
Weighted average interest rate for the year		0.82%	0.85%
Weighted average interest rate at year-end		0.87	0.79
Weighted average maturity (years)		0.10	0.10

The Bank's investment policies establish the minimum amount of acceptable collateral. The market prices of the collateral are revised monthly and the margin amount adjusted accordingly. The aggregate market value of the securities underlying the agreements outstanding at June 30, 2012 and 2011 were $67,592,000 and $303,503,000, respectively.

(3) Investments

As of June 30, 2012 and 2011, the Bank had the following investments:

		June 30, 2012	
Investment type		Fair value	Weighted average maturity (years)
Federal Home Loan Bank – MBS	$	2,233,027	2.5
Federal National Mortgage Association – MBS – notes payable program		95,000,000	See below
Federal Farm Credit Bank – MBS – notes payable program		34,000,000	See below
Municipal bonds		205,150,520	1.5
Municipal bonds – notes payable program		268,334,011	See below
Corporate paper – notes payable program		275,000,000	See below
Collateralized mortgage obligations (residential)		155,970,190	2.4
Collateralized mortgage obligations – notes payable program (residential)		53,992,275	See below
External investment pools		33,391,455	N/A
Equity investments		2,129,720	N/A
Total fair value	$	1,125,201,198	

	June 30, 2011	
Investment type	**Fair value**	**Weighted average maturity (years)**
Federal Home Loan Bank – MBS	$ 4,058,141	4.1
Federal National Mortgage Association – MBS – notes payable program	50,000,000	See below
Municipal bonds	6,695,930	6.7
Municipal bonds – notes payable program	227,068,517	See below
Corporate paper – notes payable program	275,000,000	See below
Collateralized mortgage obligations (residential)	163,809,775	2.9
Collateralized mortgage obligations – notes payable program (residential)	55,745,014	See below
External investment pools	33,856,334	N/A
Equity investments	2,708,003	N/A
Total fair value	$ 818,941,714	

Interest rate risk – In accordance with its investment policy, the Bank manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio generally to less than three years.

Those investments related to the notes payable programs involve matched transactions that generate a fixed spread of income to the Bank. These were directly approved by the Bank's board of directors and are not subject to the maximum maturity policy. As of June 30, 2012 and 2011, the investments which serve as collateral to the notes payable program have a weighted average maturity of 9.1 and 8.4 years, respectively.

In addition, investments in external investment pools and equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. These instruments are not sold on secondary markets and are not priced in any stock exchange, and as such, its fair value depends on the performance of the involved enterprises. The inherent risk in these investments is managed through credit analysis, periodic reviews of results of operations, and meetings with subject companies and investment pools managers.

Credit risk – The Bank's investment policy limits long-term investment in corporate debt to the top three ratings issued by nationally recognized statistical rating organizations, and short-term investments in corporate debt to the top two ratings issued by nationally recognized statistical rating organizations.

As of June 30, 2012, the Bank’s investments in corporate paper were rated B+ by Standard & Poor’s and Ba1*- by Moody’s Investor Service; the Bank’s investments in collateralized mortgage obligations were rated AAA/A+, AAA, A, BB-, B, or D by Standard & Poor’s and AAA/F1, AAA, AA or D by Fitch Ratings; the Bank’s investment in Federal National Mortgage Association and Federal Home Loan Bank were rated AAA/A+ or AAA by Standard & Poor’s, Aaa by Moody’s Investor Service and AAA/F1 by Fitch Ratings; and the Bank’s investment in municipal bonds were rated AAA, AA-, A+, A- or BBB by Standard & Poor’s and AAA, Aa1, Aa3, A1, A2, A3 or Baa2 by Moody’s Investor Service.

As of June 30, 2011, the Bank’s investments in corporate paper were rated B+ by Standard & Poor’s and Ba1 by Moody’s Investor Service; the Bank’s investments in collateralized mortgage obligations were rated AAA, BBB*, BB, BB-, or D by Standard & Poor’s and AAA, BBB, or D by Fitch Ratings; the Bank’s investment in Federal National Mortgage Association and Federal Home Loan Bank were rated AAA/A+ or AAA by Standard & Poor’s and Aaa by Moody’s Investor Service; and the Bank’s investment in municipal bonds were rated AAA, AA+or BBB by Standard & Poor’s and AAA, AA, or A- by Fitch Ratings.

The Bank, through EDBCI, also invests in venture capital through external investment pools and through direct investment in equity securities. The Bank’s investments in external investment pools and equity securities are not rated by a nationally recognized statistical rating organization. The related credit risk is measured through credit analysis, periodic reviews of results of operations, and meetings with subject companies’ management. In addition, a reserve for possible losses in venture capital investments is recorded as a measure of providing a fair value in the financial statements. As of June 30, 2012 and 2011, the venture capital balances comprised the following:

		2012	2011
External investment pools	$	33,391,455	33,856,334
Equity investments		8,554,000	9,254,000
		41,945,455	43,110,334
Allowance for losses in venture capital investments		(6,424,280)	(6,545,997)
Fair value of venture capital investments	$	35,521,175	36,564,337

The investment strategy of the external investment pools is to seek companies in or outside Puerto Rico that require capital growth or seed capital; although the investment recipients must have operations in Puerto Rico. The current investments on external equity investment pools are on different investment stages of their life cycle. Some of the funds continue evaluating new investment alternatives and others are in its sell-off stage.

In accordance with the partnership agreements for each of the external investment pools, the Bank's investments can only be redeemed upon distribution from funds managers; usually in the form of a sale of its holdings or dividends distributed. The assets held by the funds in sell-off stage should be liquidated within the next three years; whereas the assets held by investment stage funds will take from seven to ten years for liquidation, as expected per its respective partnership agreements. As of June 30, 2012, the Bank does not intend to sell or redeem investments in any external investment pool for an amount different to that presented in the financial statements.

Custodial credit risk deposits – Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the Bank may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2012 and 2011, securities investments were registered in the name of the Bank and were held in the possession of the Bank's custodian institution.

The Bank was exposed to the following custodial credit risk for investments held at June 30, 2012:

	2012	2011
Uninsured and registered, with securities held by the counterparty's trust department or agent in the Bank's name	$ 1,089,680,023	782,377,377
Uninsured and unregistered, with securities held by the Bank	35,521,175	36,564,337
Total	$ 1,125,201,198	818,941,714

Concentration of credit risk – The Bank places no limit on the amount it may invest in any one issuer as a percentage of the investment portfolio. As of June 30, 2012, more than 5% of the Bank's investments are in Municipal Bonds (42.1%), Popular Inc. (the Issuer) corporate notes (24.4%), Federal National Mortgage Association CMO's (8.4%) and Federal Home Loan Mortgage Corporation REMIC CMO's (5.8%). As of June 30, 2011, more than 5% of the Bank's investments are in Popular Inc. (the Issuer) corporate notes (33.6%), Municipal Bonds (27.8%), Federal National Mortgage Association REMIC CMO's (8.1%), Federal Home Loan Mortgage Corporation REMIC CMO's (8.2%) and Federal National Mortgage Association CMO's (6.1%).

Proceeds from sales, principal payments, and maturities of investments, including equity investments and gross realized gains or losses, for the years ended June 30, 2012 and 2011 are as follows:

	2012	2011
Proceeds from sales	$ 31,061,867	97,081,993
Proceeds from principal payments and maturities	414,845,600	199,127,939
Gross gains	95,717	307,405

(4) Loans and Allowance for Loan Losses

The balance of current and noncurrent loans consists of loans originated by the Bank and amounts paid under the loan guarantee program. During the years ended June 30, 2012 and 2011, the Bank has made no payments under the loan guarantee program.

Loans distribution among industry sectors as of June 30, 2012 and 2011 are as follows:

	2012	2011
Agricultural	$ 36,362,265	39,361,066
Commercial	66,227,055	57,121,646
Services	120,414,070	101,748,434
Manufacturing	29,972,885	34,706,662
Tourism	17,697,051	21,522,289
Total loans	270,673,326	254,460,097
Allowance for loan losses	(31,000,686)	(34,134,773)
	$ 239,672,640	220,325,324

The Bank has defined impaired loans as all loans with interest and/or principal past due 90 days or more and other loans for which, based on current information, it is probable that the debtor will be unable to pay according to the contractual terms of the loan agreement. The Bank generally measures impairment based upon the present value of a loan's expected future cash flows, except where foreclosure or liquidation is probable or when the primary source of repayment is provided by collateral. In these circumstances, impairment is measured based upon the fair value of the collateral less estimated selling and disposal costs. The present value of a loan's expected future cash flows is calculated using the loan's effective interest rate based on the original contractual terms.

Cash payments received on impaired loans are recorded in accordance with the contractual terms of the loan. The principal portion of the payments is used to reduce the principal balance of the loan; the interest portion is recognized as interest income. When management believes that collectibility of principal is doubtful, the interest portion may be applied to principal.

At June 30, 2012 and 2011, loan receivables delinquency by industry sector was a follows:

	2012				
	0 – 29 Days	**30 – 59 Days**	**60 – 89 Days**	**90+ Days**	**Balance outstanding**
Agricultural	$ 25,050,726	591,703	530,049	10,189,787	36,362,265
Commercial	61,777,917	237,688	1,292,024	2,919,426	66,227,055
Services	109,994,400	1,740,142	506,603	8,172,925	120,414,070
Manufacturing	28,416,228	23,800	298,401	1,234,456	29,972,885
Tourism	14,677,112	—	—	3,019,939	17,697,051
	$ 239,916,383	2,593,333	2,627,077	25,536,533	270,673,326

	2011				
	0 – 29 Days	**30 – 59 Days**	**60 – 89 Days**	**90+ Days**	**Balance outstanding**
Agricultural	$ 23,555,703	1,097,501	552,867	14,154,995	39,361,066
Commercial	49,628,466	1,614,253	312,212	5,566,715	57,121,646
Services	87,423,449	2,220,032	1,492,439	10,612,514	101,748,434
Manufacturing	32,099,503	61,257	447,384	2,098,518	34,706,662
Tourism	10,717,075	—	—	10,805,214	21,522,289
	$ 203,424,196	4,993,043	2,804,902	43,237,956	254,460,097

The following is a summary of information on loans considered to be impaired in accordance with ASC Subtopic 310-35-35, previously, FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan, as of June 30, 2012 and 2011 and the related interest income for the years then ended:

	2012	**2011**
Recorded investment in impaired loans not requiring an allowance for loan losses	$ 36,510,000	26,515,000
Recorded investment in impaired loans requiring an allowance for loan losses	39,528,000	51,590,000
Total recorded investment in impaired loans	$ 76,038,000	78,105,000
Related valuation allowance	$ 11,981,000	14,945,000
Average recorded investment in impaired loans	75,971,000	77,889,000
Interest income recognized	1,132,000	637,000

At June 30, 2012 and 2011, loans on which the accrual of interest has been discontinued (cash basis loans), due to delinquency over 89 days and/or due to restructurings, amounted to $105,402,475 ($25,501,713 over 89 days and $79,900,762 restructured loans) and $98,064,924 ($43,241,206 over 89 days and $54,823,718 restructured loans), respectively. The additional interest income that would have been recorded if these loans had performed in accordance with their original terms is estimated at approximately $8,300,000 and $8,188,000 as of June 30, 2012 and 2011, respectively.

The balance of nonaccrual loans by industry sector at June 30, 2012 and 2011, were as follows:

		2012	2011
Agricultural	$	21,448,893	23,759,110
Commercial		21,234,277	19,257,664
Services		37,196,744	27,712,252
Manufacturing		10,853,721	11,872,911
Tourism		14,668,840	15,462,987
	$	105,402,475	98,064,924

During the year ended June 30, 2012, a total of 54 loans were classified as troubled debt restructurings. The balance of these loans by industry sector and the related effect in the allowance for loan losses at June 30, 2012 is as follows:

		2012	
		Principal	Allowance
Agricultural	$	3,038,398	272,819
Commercial		2,224,092	1,242,681
Services		8,025,712	2,048,166
Manufacturing		2,197,843	813,652
Tourism		2,916,955	182,120
	$	18,403,000	4,559,438

Of the total troubled debt restructurings during 2012, 9 contracts with a balance at June 30, 2012 of $783,595, defaulted after their modifications were processed. The following table presents the troubled debt restructurings modified during the year ended June 30, 2012:

		2012	
		Pre-modification	**Post-modification**
Outstanding recorded investment	$	21,244,897	21,254,164
Number of Contracts		54	54
Weighted average rate		6.01%	6.08%
Weighted average term (months)		87	80

At June 30, 2012 and 2011, commitments to extend credit on troubled debt restructured loans amounted to $945,000 and $2,098,000, respectively.

Changes in the total allowance for loan losses for the years ended June 30, 2012 and 2011 were as follows:

		2012	**2011**
Balance, beginning of year	$	34,134,773	39,573,927
Provision charged to operations		8,600,000	18,750,000
Loans charged off as uncollectible		(15,434,666)	(25,849,260)
Recoveries		3,700,579	1,660,106
Balance, end of year	$	31,000,686	34,134,773

The following table presents the changes and the balance in the allowance for loan losses and the recorded investment in gross loans by industry sector and based on impairment method for the year ended June 30, 2012:

	2012						
		Agricultural	Commercial	Services	Manufacturing	Tourism	Total
Allowance for loan losses:							
Beg. balance	$	3,776,930	10,717,464	14,483,922	4,050,113	1,106,344	34,134,773
Provision charged (reversed) to/from operations		(319,610)	2,207,246	3,279,785	1,243,478	2,189,101	8,600,000
Loans charged-off as uncollectible		(2,355,452)	(3,511,406)	(5,720,866)	(1,590,349)	(2,256,593)	(15,434,666)
Recoveries		1,330,662	473,682	1,724,119	169,592	2,524	3,700,579
Ending balance	$	2,432,530	9,886,986	13,766,960	3,872,834	1,041,376	31,000,686
Ending allowance attributable to loans:							
Individually evaluated for impairment	$	646,342	4,964,833	3,771,378	2,209,994	388,441	11,980,988
Collectively evaluated for impairment		1,786,188	4,922,153	9,995,582	1,662,840	652,935	19,019,698
Ending allowance	$	2,432,530	9,886,986	13,766,960	3,872,834	1,041,376	31,000,686
Loans:							
Individually evaluated for impairment	$	16,448,714	16,506,598	20,653,115	12,256,415	10,173,122	76,037,964
Collectively evaluated for impairment		19,913,551	49,720,457	99,760,955	17,716,470	7,523,929	194,635,362
Total loan balance	$	36,362,265	66,227,055	120,414,070	29,972,885	17,697,051	270,673,326

(Continued)

(5) Capital Assets

Capital assets activity for the years ended June 30, 2012 and 2011 was as follows:

	2012			
	Beginning balance	Increases	Decreases	Ending balance
Land	$ 2,735,000	—	—	2,735,000
Building and improvements	11,143,249	138,344	—	11,281,593
Furniture and equipment	5,037,544	48,915	(153,260)	4,933,199
Total cost	18,915,793	187,259	(153,260)	18,949,792
Less accumulated depreciation and amortization:				
Building and improvements	(4,750,575)	(284,695)	—	(5,035,270)
Furniture and equipment	(4,763,473)	(121,468)	153,260	(4,731,681)
Total accumulated depreciation and amortization	(9,514,048)	(406,163)	153,260	(9,766,951)
Capital assets, net	$ 9,401,745	(218,904)	—	9,182,841

	2011			
	Beginning balance	Increases	Decreases	Ending balance
Land	$ 2,735,000	—	—	2,735,000
Building and improvements	10,972,634	170,615	—	11,143,249
Furniture and equipment	5,071,030	123,489	(156,975)	5,037,544
Total cost	18,778,664	294,104	(156,975)	18,915,793
Less accumulated depreciation and amortization:				
Building and improvements	(4,481,841)	(268,734)	—	(4,750,575)
Furniture and equipment	(4,780,143)	(140,305)	156,975	(4,763,473)
Total accumulated depreciation and amortization	(9,261,984)	(409,039)	156,975	(9,514,048)
Capital assets, net	$ 9,516,680	(114,935)	—	9,401,745

The Bank's principal premises are partially rented to various lessees under lease terms expiring at various future dates. Minimum future rentals to be received for the next two years ended June 30, 2013 and 2014 are approximately $313,000 and $55,000, respectively.

Rent revenue amounting to approximately $432,000 and $399,000 was recorded as other income in the accompanying 2012 and 2011 statements of revenue, expenses, and changes in net assets, respectively.

(6) Other Assets

Other assets as of June 30, 2012 and 2011 consist of the following:

		2012	2011
Other real estate owned, net of allowance for losses of $6,118,519 in 2012 and $4,802,110 in 2011	$	6,200,513	4,331,308
Deferred issuance costs		126,091	135,101
Accounts receivable from other Commonwealth component units		65,516	556,457
Other		52,754	537,229
Total	$	6,444,874	5,560,095

(7) Time Deposits

Time deposits consist of deposits with fixed maturity dates (not exceeding 12 months) received from other governmental institutions, commercial banks, or other financial institutions. Governmental time deposits (Commonwealth and its component units) are exempt by law from the collateral requirement applicable to commercial financial institutions, which are depositors of public funds. Governmental time deposits at June 30, 2012 and 2011 amounted to approximately $481,998,000 and $346,434,000, respectively.

Time deposits in denominations of $100,000 or more amounted to approximately $543,614,000 and $454,608,000 at June 30, 2012 and 2011, respectively.

(Continued)

(8) Securities Sold under Agreements to Repurchase

The Bank's investment policies, as authorized by Act number 22 of July 24, 1985, Article 3, allow management to sell securities under agreements to repurchase. The following table summarizes certain information on securities sold under agreements to repurchase:

		2012	2011
Carrying amount at June 30	$	123,925,000	137,400,000
Average amount outstanding during the year		151,811,000	143,713,000
Maximum amount outstanding at any month-end		171,210,000	174,550,000
Weighted average interest rate for the year		1.88%	2.42%
Weighted average interest rate at year-end		1.66	2.32

Securities sold under agreements to repurchase represent borrowings with maturities ranging from 13 to 635 days at June 30, 2012 and from 21 to 1,001 days at June 30, 2011.

As of June 30, 2012 and 2011, securities sold under agreements to repurchase were collateralized with mortgage-backed securities, other government agencies securities, and other investments with a market value of $132,091,000 and $148,578,000, respectively.

The activity for securities sold under agreements to repurchase during 2012 and 2011 was as follows:

		2012				
		Beginning balance	Increases	Decreases	Ending balance	Amounts due within one year
Securities sold under agreement to repurchase	$	137,400,000	957,091,000	(970,566,000)	123,925,000	104,925,000

		2011				
		Beginning balance	Increases	Decreases	Ending balance	Amounts due within one year
Securities sold under agreement to repurchase	$	177,750,000	286,384,000	(326,734,000)	137,400,000	86,600,000

(9) Promissory Notes and Other Note Payable

Promissory notes and other note payable at June 30, 2012 and 2011 are summarized as follows:

		2012	2011
Promissory notes	$	726,140,838	607,817,093
Other note payable		9,892,646	10,336,741
Total	$	736,033,484	618,153,834

On May 22, 2003, the Bank was authorized to issue up to $300 million in collateralized promissory notes. During the fiscal year 2005, the authorized amount was increased up to $500 million. During fiscal year 2008, the Bank, through its subsidiary EDBCI, was authorized to issue an additional $275 million in collateralized promissory notes. The proceeds received by the Bank from the sale of these notes shall be invested in obligations that qualify as permitted investments under applicable laws and the investment guidelines adopted by the Bank. Such notes have maturities not exceeding 20 years. These notes contain certain put options held by the Bank and by the creditor. The put options of the Bank grant the Bank the exercisable right, at the Bank's sole discretion, to require the noteholder to purchase, on established exercise dates, the collateral of this note at a price equal to the amortized cost of the promissory notes, as defined. The put option held by the noteholders permits them, on the same established dates of the Bank's put option, to require the Bank to redeem the promissory notes at their outstanding amortized cost. The mirror put options held by the Bank are considered in accounting for the fair value of the underlying investments. As a result, no separate asset or obligation is recorded related to the put options.

At June 30, 2012 and 2011, the aggregate principal balance of promissory notes outstanding under these programs amounted to $726 million and $608 million, respectively. These notes pay interest semiannually, bear interest rates at June 30, 2012 ranging from 2.25% to 7.23%, and mature at various dates through October 24, 2031. These promissory notes are collateralized with investment securities with an aggregate fair value of $776,038,000, excluding the value of their corresponding put options.

The other note payable is due to the Government Development Bank of Puerto Rico (GDB) (collateralized by a real estate mortgage) bears interest at the rate of 6% per annum, pays interest semiannually in June and December, and principal is paid each June. The note matures on June 1, 2026 and provides for annual payments of $1,064,300 including interest.

Promissory notes and other note payable activity for the years ended June 30, 2012 and 2011 was as follows:

	2012				
	Beginning balance	Increases	Decreases	Ending balance	Amounts due within one year
Promissory notes	$ 607,817,093	170,715,892	(52,392,147)	726,140,838	41,800,000
Other note payable	10,336,741	—	(444,095)	9,892,646	470,741
Total promissory notes and other notes payable	$ 618,153,834	170,715,892	(52,836,242)	736,033,484	42,270,741

	2011				
	Beginning balance	Increases	Decreases	Ending balance	Amounts due within one year
Promissory notes	$ 456,320,815	153,104,587	(1,608,309)	607,817,093	—
Other note payable	10,755,699	—	(418,958)	10,336,741	444,095
Total promissory notes and other notes payable	$ 467,076,514	153,104,587	(2,027,267)	618,153,834	444,095

The maturities and interest payments of the promissory notes and the note payable for each of the next five fiscal years and thereafter are as follows:

	Principal	Interest
Year ending June 30:		
2013	$ 42,270,741	39,683,427
2014	498,985	38,424,031
2015	78,528,924	35,650,293
2016	50,985,338	31,640,685
2017	120,594,299	25,945,449
2018 – 2021	182,112,826	101,083,993
2022 – 2026	132,202,371	30,091,003
2027 – 2032	128,840,000	20,577,419
	$ 736,033,484	323,096,300

(10) Other Liabilities

The activity for the other noncurrent liabilities during 2012 and 2011 was as follows:

	2012			
	Beginning balance	Increases	Decreases	Ending balance
Compensated absences	$ 2,059,293	324,000	(260,014)	2,123,279
Legal claims	950,222	—	(264,000)	686,222
Reserve for loan guarantees	9,171,785	—	(3,945,848)	5,225,937
	$ 12,181,300	324,000	(4,469,862)	8,035,438

	2011			
	Beginning balance	Increases	Decreases	Ending balance
Compensated absences	$ 2,222,985	160,000	(323,692)	2,059,293
Legal claims	950,222	—	—	950,222
Reserve for loan guarantees	10,170,052	—	(998,267)	9,171,785
	$ 13,343,259	160,000	(1,321,959)	12,181,300

(11) Net Assets

The Bank's net assets invested in capital assets and restricted as of June 30, 2012 and 2011 are composed of the following:

	2012	2011
Invested in capital assets, net of related debt:		
Capital assets	$ 18,949,792	18,915,793
Accumulated depreciation and amortization	(9,766,951)	(9,514,048)
Related GDB note	(9,892,646)	(10,336,741)
Total	$ (709,805)	(934,996)
Restricted for special loan programs:		
Economic Development Administration	$ 3,625,271	3,865,829
Day Care Centers Loan Fund	4,703,414	4,583,264
State Small Business Credit Initiative	4,829,184	—
Total	$ 13,157,869	8,449,093

(Continued)

The Bank is a recipient of two grants from the Economic Development Administration Directive System (EDA), subscribed by the U.S. Department of Commerce to operate a program under a Revolving Loan Fund directed to assist businesses that suffered physical or economic damage due to the effects of Hurricane Hugo, and to advance the economic development of Puerto Rico. The Bank matched EDA's award pursuant to the terms of the grant agreements. The funds received from the collection of principal and interest of loans granted under the program are deposited in the fund to be used to disburse new qualified loans. At June 30, 2012 and 2011, the outstanding principal of loans granted under the terms of EDA Revolving Loan Fund amounted to $2,302,897 and $3,658,986, respectively, and are included in loans, net in the accompanying statements of net assets. The grants are routinely subject to financial and compliance audits in accordance with the provisions of the U.S. Office of Management and Budget Circular A-133 or to compliance audits by EDA. The latter has the authority to determine liabilities as well as to limit, suspend, or terminate the federal assistance.

On October 6, 1989, a revolving loan fund grant that was administrated by GDB was transferred to the Bank for administration under the same terms as when the program was established by GDB. At the time, such fund had a total contribution of $1,250,000 ($1,000,000 from EDA and $250,000 from GDB) and a portfolio consisting of 15 loans with an aggregate outstanding principal balance of $504,299. The fund was pooled into the fund previously administered by the Bank when the Bank reimbursed $250,000 to GDB for their original contribution to such fund. As a result, the Bank's contribution to the fund equals 25% of EDA's contribution to the fund.

The Commonwealth approved Law No. 212 of August 29, 2000, as amended, which creates the Day Care Centers Loan Fund, for the purpose of financing the development of day care centers for children, multiple activity centers for elderly persons, and long-term care institutions. The Bank is responsible for the administration of the fund. At June 30, 2012 and 2011, the outstanding principal of loans granted under the terms of the Day Care Centers Loan Fund amounted to $2,788,577 and $3,465,087, respectively, and are included in loans, net in the accompanying statements of net assets.

In September 2011, the Bank was approved an allocation of $14.5 million from the U.S. Department of the Treasury (Treasury) under the State Small Business Credit Initiative Act of 2010, Title 3 of the Small Business Jobs Act of 2010 (SSBCI), by which the United States Congress appropriated funds to Treasury to be allocated and disbursed to States and Territories that have created programs to increase the amount of capital made available by private lenders to small businesses. To accomplish this Puerto Rico will use $12.5 million of its allocated SSBCI funds to support the existing Loan Participation Program and $2 million to support the existing Venture Capital Program. As of June 30, 2012 the Bank has received $4.8 million of the total allocation, which was recorded as a capital contribution, and has disbursed $2 million dollars under the Loan Participation Program.

Restricted net assets related to the special loans programs as of June 30, 2012 and 2011 consist of the following:

		2012	2011
Cash and due from banks	$	6,824,238	2,845,593
Loans and interest receivable, net of allowance for loan losses of $761,327 and $1,681,769 in 2012 and 2011, respectively		6,330,147	5,457,071
Other assets		272,263	167,521
Total restricted assets		13,426,648	8,470,185
Accounts payable and other liabilities		268,779	21,092
Total restricted net assets	$	13,157,869	8,449,093

(12) Interagency Agreements

The Bank has entered into interagency agreements with various government agencies. Such agreements provide for the deposit of funds in the Bank amounting in the aggregate to approximately $2 million to be used for loan programs to benefit socially and economically disadvantaged families and unemployed persons. Loans are granted based on the requirements established by such governmental agencies and the Bank is responsible for the administration of the loan portfolio. At June 30, 2012, these fund programs had made payments of approximately $150,000 to the Bank for loans guaranteed; therefore, these loans are not included in the accompanying statements of net assets.

The Bank entered into an interagency agreement with the Economic Development and Commerce Department (a governmental unit of the Commonwealth). Such agreement provides for the transfer of the funds from the previously created Hurricane Georges Guarantee Loan Fund and the Education Loan Program Guarantee Fund to a new loan fund program. The new loan fund program grants direct loans and guarantees to small- and medium-sized entrepreneurs in the economic sectors of manufacturing, services, and commerce. Guarantee claims under Hurricane Georges Guarantee Loan Fund and Education Loan Program Guarantee Fund may be paid by the new fund. At June 30, 2012 and 2011, the outstanding principal of loans granted under all the Economic Development and Commerce Department loans and loan guarantee programs amounted to $7,230,952 and $8,045,293, respectively, of which $3,970,686 and $4,531,589, respectively, are included in loans, net in the accompanying statements of net assets, while the remaining balance had been paid to the Bank by the new fund.

The Bank entered into an interagency agreement with the Tourism Company of Puerto Rico (a component unit of the Commonwealth) to create the Loan and Guarantee Tourism Fund. At June 30, 2012 and 2011, the outstanding principal of loans granted under this fund amounted to $10,816,052 and $15,731,547, respectively, and are included in loans, net in the accompanying statements of net assets.

On August 17, 2001, the Commonwealth approved Law No. 117, which creates the Agricultural Guarantee Loan Fund to secure loans granted by the Bank and commercial banks to farmers and agricultural entities.

This fund will be financed through annual appropriations to be provided by the Commonwealth up to $100 million during a four-year period. The Bank has entered into an alliance with the Commonwealth's Department of Agriculture (the Department) for the administration of this fund, which among other things, requires that the Department establish the operational procedures of the Fund, while the Bank will administer the fund. At June 30, 2008, the fund had received $10 million related to the initial appropriation, which was deposited in the Bank. At June 30, 2012 and 2011, the outstanding principal of all loans granted under the Agricultural Guarantee Loan Fund program amounted to $10,362,312 and $12,286,816, respectively, of which $5,639,107 and $7,515,449, respectively, are included in loans, net in the accompanying statements of net assets, while the remaining balance had been paid to the Bank by the fund.

The Bank entered into an interagency agreement with the Department of Agriculture (a governmental unit of the Commonwealth) and the Fund for the Comprehensive Development of the Agriculture, a component unit of the Puerto Rico Land Authority (a component unit of the Commonwealth), to create the Guarantee Loan Program – "La Llave para tu Agro-empresa." At June 30, 2012 and 2011, the outstanding principal of loans granted under the program amounted to $4,766,535 and $4,749,646, respectively, of which $3,298,585 and $3,369,854, respectively, are included in loans, net in the accompanying statements of net assets, while the remaining balance had been paid to the Bank by the fund.

The financial statements of these funds are audited by other independent auditors whose reports thereon for the year ended June 30, 2011, dated December 28, 2010, express an unqualified opinion. Audit of these funds for the year ended June 30, 2012 has not been completed as of issuance date of the Bank's basic financial statements. These funds are not included within the Bank's basic financial statements.

The Bank and the governmental agencies participating in the interagency agreements described above are jointly liable for any litigation that may arise in connection with the administration of such loan programs. At June 30, 2012 and 2011, there was no pending or threatened litigation under such programs.

(13) Commitments and Contingencies

(a) Litigation

At June 30, 2012, the Bank is a defendant in various lawsuits arising from the ordinary course of business. Management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, resulting from such lawsuits would not be material in relation to the Bank's financial position and results of operations.

Because of the uncertainties inherent in the evaluation of pending or threatened litigation, the Bank's ultimate liability under such claims may be significantly different from management's current estimate.

(b) Loan Guarantee Program

On March 9, 2009, the Commonwealth approved Law No. 9, which creates the Loan Guarantees Program for the Small and Medium Businesses. Under the program, the GDB, a component unit of the Commonwealth, assigned $180 million to the Bank to secure loans granted by commercial banks and other financial institutions ranging from $5,000 to $250,000 and in accordance with the criteria established by the law and the Bank's policies. The purpose of this program is to facilitate credit to enterprises affected by lack of liquidity or lack of sufficient collateral to back up their loans. At June 30, 2012 and 2011, the outstanding principal of loans granted under the program amounted to $3,365,000 and $4,656,047, respectively.

At June 30, 2012 and 2011, total outstanding loan guarantees, including guarantees under the new program mentioned above, amounted to approximately $3,556,000 and $5,054,000, respectively. The Bank has recorded a reserve for loan guarantees amounting to approximately $2,296,000 and $2,573,000 at June 30, 2012 and 2011, respectively, which is included in other current liabilities in the accompanying statements of net assets. During 2010, the Bank received $10 million from the GDB to cover any losses that may arise from the operation of the Loan Guarantees Program described above. This amount was recorded in the reserve for loan guarantees under noncurrent other liabilities in the accompanying financial statements. See note 20 on related-party transactions.

From the reserve for loan guarantees, which as of June 30, 2012 has a balance of $5,226,000, the Bank reassigned during 2011 $5 million for disbursements of loans under the "Desarrollo para el Pueblo" program and $2 million for disbursements of loans under the "Vieques y Culebra" program. Up to June 30, 2012, $4.1 million have been disbursed for the two programs, leaving $2.9 million in the reserve for this purpose. Thus, a remaining balance of $2.3 million continues to represent a reserve for the $3.4 million in loan guarantees outstanding as of June 30, 2012. See also note 20.

(c) Other Risks

The Bank is exposed to various risks of loss related to torts, theft, casualty, errors, and omissions and other losses for which the Bank carries commercial insurance. Settled claims have not exceeded insurance coverage in any of the past three fiscal years. Also, the Bank obtains workers' compensation coverage from another component unit of the Commonwealth.

(14) Fair Values of Financial Instruments

The following summarizes the methods and assumptions used by the Bank in estimating the fair values of financial instruments:

- *Cash and Due from Banks* – The amount reported in the statements of net assets for cash and due from banks approximates its fair value.
- *Securities Purchased under Agreements to Resell* – Maturity dates of securities purchased under agreements to resell at June 30, 2012 and 2011 are less than one year. The amount reported in the statements of net assets approximates its fair value due to the short-term maturities and the nature of the instruments.
- *Investment in Debt Securities* – Debt securities are carried at fair value. Debt securities that are primarily traded in secondary markets were valued using market prices, pricing models, or quoted market prices of financial instruments with similar characteristics.
- *External Investment Pools and Equity Investments* – The fair value of investment positions in external investment pools was estimated by the pools' managers in the absence of readily

ascertainable market values. The Bank uses net asset value of the investment pools as a practical expedient to compute the fair value of its investment positions, following the provisions of ASU 2009-12 *Investments in Certain Entities That Calculate Net Asset Value per Share* (or its Equivalent). The carrying value of investments in equity securities of local enterprises approximates fair value as estimated by management based on an evaluation of the investees' financial position.

- *Loans* – Given the type of development loans originated by the Bank, and the level of nonaccrual and impaired loans, it is not practicable to estimate fair value of the portfolio.
- *Accrued Interest Receivable* – The amounts reported in the statements of net assets approximate fair value because of the short-term nature of this balance.
- *Time Deposits* – Maturity dates of time deposits range from 2 to 194 days. The carrying amounts approximate their fair values at the reporting date due to the short-term maturities.
- *Securities Sold under Agreements to Repurchase* – Maturity dates of securities sold under agreements to repurchase at June 30, 2012 and 2011 are less than one year except for one security amounting to $19 million, which mature March 27, 2014, and three securities amounting to $50.8 million, which mature between December 6, 2012 and March 27, 2014, respectively. The fair value at the reporting date of the short term instruments approximate its carrying amounts. It is not practicable to determine the fair value of the long term instruments.
- *Promissory Notes and Other Note Payable* – The fair value of promissory notes with variable interest rates and of the other note payable with a fixed rate approximates their carrying value, considering related put options. Pertinent information concerning these transactions is provided in note 9.
- *Accrued Interest Payable* – The amounts reported in the statements of net assets approximate fair value because of the short-term nature of this balance.

The carrying value and fair value of financial instruments are as follows:

		2012		2011	
		Carrying value	**Fair value**	**Carrying value**	**Fair value**
		(In thousands)			
Financial assets:					
Cash and due from banks	$	5,480	5,480	6,463	6,463
Interest-bearing deposits		121,500	121,500	30,102	30,102
Securities purchased under agreements to resell		62,251	62,251	281,021	281,021
Investments		1,125,201	1,125,201	818,942	818,942
Loans		239,673	N/A	220,325	N/A
Accrued interest receivable		9,358	9,358	7,219	7,219
Financial liabilities:					
Time deposits	$	543,614	543,614	454,620	454,620
Securities sold under agreements to repurchase-short term		104,925	104,925	86,600	86,600
Securities sold under agreements to repurchase-long term		19,000	N/A	50,800	N/A
Promissory notes and other note payable		736,033	736,033	618,154	618,154
Accrued interest payable		6,901	6,901	6,049	6,049

(15) Significant Group Concentrations of Credit and Market Risk

The Bank’s business activities are with customers located in Puerto Rico. The Bank’s loan transactions are all directed toward small- and medium-size businesses in all sectors of Puerto Rico’s economy. The collateral held on the Bank’s loans varies, but usually includes chattel and real estate mortgages.

(16) Retirement Plans

(a) Defined Benefit Pension Plan

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

The System provides retirement, death, and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. 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. Retirement benefits depend upon age at retirement and number of years of creditable service. Benefits vest after 10 years of plan participation.

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

Total employee contributions during the years ended June 30, 2012 and 2011 to the above plan amounted to approximately $269,000 and $284,000, respectively. Total payroll covered for the years ended June 30, 2012 and 2011 was approximately $3,294,000 and $3,485,000, respectively.

The Bank's contributions during the years ended June 30, 2012 and 2011 to the above plan amounted to $350,000 and $323,000, respectively, which represented 100% of required contributions.

(b) Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305, which amends Act No. 447, to establish, among other things, a new defined benefit contribution savings plan program (System 2000).

System 2000 became effective on January 1, 2000. Employees participating in the System as of December 31, 1999 elected either to stay in the defined benefit plan or to transfer to System 2000. New regular employees of the government on or after January 1, 2000 became members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which is invested by the System, together with those of the System. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on the employees' contribution (with a minimum of 8.275% of the employees' salary up to a maximum of 10% of the monthly gross salary), which will be invested in one of three investment options. The Bank's required contribution is 9.275% of the employees' salary.

System 2000 reduces the retirement age from 65 years to 60 years for those employees who joined the current plan on or after April 1, 1990.

Total employee contributions during the years ended June 30, 2012 and 2011 to the above plan amounted to approximately $189,000 and $170,000, respectively. Total payroll covered for the years ended June 30, 2012 and 2011 was approximately $2,266,000 and $2,049,000, respectively.

The Bank's contributions during the years ended June 30, 2012 and 2011 to the above plan amounted to $266,000 and $190,000, respectively, which represented 100% of required contributions.

Contribution rates are established commonwealth wide for all participating governmental units. Accordingly, the actuarial information and related disclosures attributable to the Bank's employees are not determinable.

Additional information on the System will be provided in its financial statements for the year ended June 30, 2012. That report may be obtained by writing to Employees' Retirement System of the Commonwealth and its Instrumentalities, P.O. Box 42003, San Juan, PR 00940-2003.

(17) Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Bank is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and to purchase investment and mortgage-backed securities, 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 statements of net assets. 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 losses for lending commitments are represented by the contractual amount of such 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, 2012 and 2011, the off-balance-sheet risks consisted of the following:

	2012	**2011**
	(In thousands)	
Financial instruments whose credit is represented by contractual amounts:		
Financial guarantees	$ 3,556	5,054
Commitments to extend credit	33,187	40,211
Commitments to invest in venture capital	8,218	10,222

Financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing financial guarantees is essentially the same as that involved in extending loan facilities to customers.

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 evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include property, plant, and equipment, and income-producing commercial properties.

(18) Other Noninterest Income

Other noninterest income for the years ended June 30, 2012 and 2011 consists of the following:

		2012	2011
Rental income (note 5)	$	431,793	398,616
Gain (loss) on sale of foreclosed assets		31,750	216,359
Administrative fees – other funds		65,242	94,327
Recoveries from loan guarantees		31,738	21,908
Miscellaneous income		329,611	395,278
Total	$	890,134	1,126,488

(19) Other Noninterest Expenses

Other noninterest expenses for the years ended June 30, 2012 and 2011 consist of the following:

		2012	2011
Electricity	$	517,068	449,720
Insurance		189,623	223,052
Repairs and maintenance		166,058	180,319
Telephone		55,619	60,022
Employees trainings and seminars		4,417	5,548
Office supplies		58,548	41,201
Reimbursement of expenses to employees		76,165	83,369
Dues and subscriptions		55,304	45,767
Investment operations		41,141	35,670
Vehicles		10,395	6,770
Postage		29,265	24,479
Official meetings		1,852	8,636
Miscellaneous		440,280	434,445
Subtotal		1,645,735	1,598,998
Legal claims		(250,000)	—
Provision for losses on foreclosed assets		750,000	1,000,000
Total	$	2,145,735	2,598,998

(20) Related-Party Transactions

On February 1, 2010, the Governor of Puerto Rico issued Executive Order OE-2010-005, which reassigned funds remaining from the local economic stimulus plan approved under Law No. 9 of the Commonwealth in March 9, 2009. In accordance with this order, the Bank received from GDB $41,250,000 to implement a program designed to promote the economic capacity of small- and medium-size enterprises. Of this total, the Bank recorded $30 million as a capital contribution aimed to generate new direct loans, $10 million as a reserve for possible losses from the Loan Guarantee Program created by the abovementioned Law No. 9, and $1,250,000 as an accrual for expenses related to a government wide effort to promote economic development of the small- and medium-size enterprise sector.

As mentioned in note 13 above, during 2011 $7 million from the reserve for possible losses from the Loan Guarantee Program were reassigned for the disbursement of loans under the “Desarrollo para el Pueblo” and “Vieques y Culebra” programs. Accordingly, $3,668,800 and $401,500 were disbursed under these programs during 2012 and 2011, respectively, and reclassified from the reserve account to capital contribution. In addition, during 2012 and 2011 the Bank received $243,300 and $72,400, respectively, from the local Administration for Energy Affairs for the disbursement of loans under the “Green Loans” program, which were also recorded as capital contribution.

(21) Subsequent Events

The Bank evaluated subsequent events through October 1, 2012, the date the basic financial statements were available to be issued.