

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
(A Component Unit of the Commonwealth of Puerto Rico)  
Basic Financial Statements and  
Required Supplementary Information  
June 30, 2017  
(With Independent Auditors' Report Thereon)

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

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## Independent Auditors' Report

The Board of Directors  
Government Development Bank for Puerto Rico:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Government Development Bank for Puerto Rico (the Bank), a component unit of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Bank's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Puerto Rico Housing Finance Authority which represent 100% of the total assets and revenues of the governmental activities, HUD Programs Fund, Home Program Fund, the Affordable Housing Mortgage Subsidy Program Fund and the Housing Finance Authority Fund; and 12% and 10% of the total assets and revenues, respectively, of the business-type activities. Those statements were audited by other auditors whose report has been furnished to us, and our opinions, insofar as it relate to the amounts included for the Puerto Rico Housing Finance Authority, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### Opinions

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Government



Development Bank for Puerto Rico, as of June 30, 2017, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

### **Emphasis of Matters**

#### *Going Concern Uncertainty*

The accompanying basic financial statements have been prepared assuming that the Bank (including its blended component units) will continue as a going concern. As discussed in note 3 to the basic financial statements, the Commonwealth and its component units have not been able to repay their loans from the Bank, which has significantly affected the Bank's liquidity and ability to repay its obligations. Also, on March 23, 2018, the Bank ceased its operations and is currently winding down in an orderly fashion under Title VI of PROMESA. Also as discussed in note 3, the Bank has stated that substantial doubt exists about its ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in notes 3, 4 and 22. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinions are not modified with respect to this matter.

#### *Restatement of Net Position and Fund Balance*

As discussed in note 5 to the basic financial statements, the net position/fund balance of the governmental activities, business-type activities, the Affordable Housing Mortgage Subsidy Program Fund, the GDB Operating Fund, and the Housing Finance Authority Fund have been restated as of July 1, 2016 to correct misstatements. Our opinions on the basic financial statements are not modified with respect to these matters.

### **Other Matter**

#### *Required Supplementary Information*

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 –22; the schedule of the Bank's proportionate share of the net pension liability and related ratios on page 110; and the schedule of Bank contributions on page 111 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 and the other auditors 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**

San Juan, Puerto Rico  
July 31, 2020

Stamp No. E419462 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



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**Management's Discussion and Analysis**

This management's discussion and analysis section ("MD&A") provides a narrative overview and analysis of the financial activities of Government Development Bank for Puerto Rico and its components units (the "Bank" or "GDB") as of and for the year ended June 30, 2017. This MD&A is intended to serve as an introduction to GDB's basic financial statements, which have the following components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements. The following presentation is by necessity highly summarized, and in order to gain a thorough understanding of GDB's financial condition, the financial statements, including the notes thereto, and required supplementary information should be reviewed in their entirety.

**Financial Highlights**

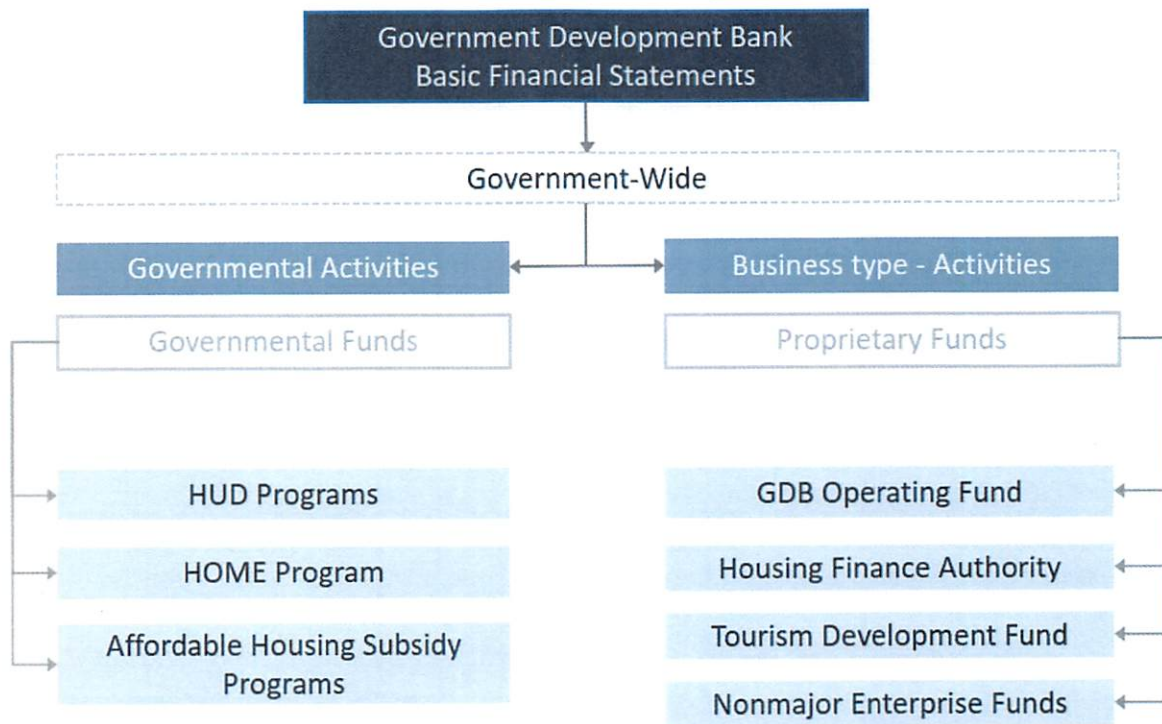
- Total assets government-wide at June 30, 2017, amounted to \$3,637 million, a decrease of \$229 million, or 5.92%, from \$3,866 million at June 30, 2016. For fiscal year 2017, liabilities decreased by \$28 million, or 0.35%, to \$7,894 million at June 30, 2017, from \$7,922 million at June 30, 2016. Total deferred outflows of resources amounted to \$53.6 million, an increase of \$19.9 million or 59%, from \$33.7 million at June 30, 2016, mostly related to pension related items related to the adoption of Governmental Accounting Standards Board's (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*.
- Net deficit government-wide increased from \$4,025 million at June 30, 2016 to \$4,208 million at June 30, 2017. The increase in net deficit of \$183 million in fiscal year 2017 is composed of a negative change in net position of approximately \$184 million from Business-Type Activities, impacted mostly by the combination of a net provision for loan losses of approximately \$103 million, excess of remaining operating expenses over total operating revenue in the amount of approximately \$73 million and nonoperating expenses of \$9 million, offset by net transfers in from Governmental Activities of approximately \$1.2 million; and a positive change in net position of approximately \$1.5 million from Governmental Activities, mostly attributed to excess of revenues over expenses of approximately \$2.7 million offset by net transfers out to Business-Type Activities of approximately \$1.2 million. The ratio of net position (deficit) to total assets increased to negative 115.2% at June 30, 2017 from negative 103.6% at June 30, 2016.
- The operating income of the GDB Operating Fund decreased from an income of \$104.4 million in 2016 to a loss of \$170.3 million, or an decrease of \$274.7 million in fiscal year 2017, mostly impacted by the combination of a provision for loan losses of approximately \$108 million in 2017 when compared to a net release in the provision for loan losses of approximately \$208 million in fiscal year 2016 (a negative impact of approximately \$316 million) and increased salaries, fringe benefits and pension expenses in the amount of approximately \$15 million, offset by no custodial credit risk losses in 2017 when compared to approximately \$37 million in 2016, lower legal and professional fees in the amount of approximately \$23 million and lower provisions for losses in real estate owned and guaranty liabilities in the amount of approximately \$9.1 million.
- Interest income on loans in the GDB Operating Fund amounted to \$237.7 million in 2017, an increase of approximately \$4.5 million over the prior year, responding mostly to an increase in the actual collection of interest income on non-accruing loans over the prior year's collection of interest on the same type of loans, slightly offset by lower accrual of interest income during 2017 as a result of a reduced volume of agencies and public corporation loans in accruing status as compared to prior year and a decreasing municipal loans portfolio.
- During fiscal year 2017, the Bank received the last of the debt appropriations from the Legislature used to partially repay some the the loans issued to the Commonwealth in the amount of \$235 million. With respect to loans to municipalities, such portfolio continued its repayment and decreasing trend with collections during fiscal year 2017 of approximately \$110.4 million, slightly offset by some \$1 million in new disbursements.

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- The Bank and its blended component unit, Housing Finance Authority, adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, effective July 1, 2016. Implementation of these new financial reporting standards required that the Bank and the Housing Finance Authority restate its beginning net position (deficit) as of July 1, 2016, by approximately \$140.7 million, reflecting the cumulative effects of applying these statements. For purposes of this MD&A, such cumulative effects have been retroactively made to the 2016 comparative figures presented herein. Net pension liability and pension expense as of and for the year ended June 30, 2017, as a result of adopting these statements amounted to \$203.4 million and \$20.7 million, respectively.

**Overview of the Financial Statements**

GDB's financial statements consist of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements. The following chart illustrates the structure of GDB for financial reporting purposes:



(a) **Government-Wide Financial Statements**

The government-wide financial statements are designed to provide readers with a broad overview of the Bank's finances, in a manner similar to a private-sector business.

- (1) Statement of Net Position (Deficit)** – This statement provides information on the Bank's assets, deferred outflows of resources and liabilities, with the difference between the assets plus deferred outflow of resources less liabilities reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Bank is improving or eroding.

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- (2) **Statement of Activities** – This statement presents information on how the Bank's net position changed during the reporting period. All changes in net position are reported as soon as the underlying events giving rise to the change occurs, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods.

In the Statement of Net Position (Deficit) and the Statement of Activities, GDB's operations are divided into two kinds of activities:

- (1) **Governmental Activities** – Governmental Activities generally are financed through intergovernmental and other non-exchange revenues.
- (2) **Business-Type Activities** – Business-Type Activities are financed in whole or in part by fees charged for goods or services and interest earned on investment securities and loans.

(b) ***Fund Financial Statements***

A fund is a fiscal and accounting entity with a self-balancing set of accounts that the Bank uses to keep track of specific sources of funding and spending for a particular purpose. The Bank's funds are divided into the following two categories:

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

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

- (2) **Proprietary Funds**– Proprietary Funds provide the same type of information as the Business-Type Activities in the government-wide financial statements, but in more detail. The proprietary fund financial statements of the Bank provide separate information on the Business-Type Activities of the Bank's blended component units.

(c) ***Notes to the Basic Financial Statements***

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

**Government-Wide Financial Analysis**

Total assets, deferred outflow of resources and total liabilities, and deferred inflow of resources of the Bank at June 30, 2017, amounted to \$3,637 million, \$53.6 million and \$7,875 million, respectively, for a net deficit of \$4,208 million or (115.7%) of total assets. Within assets, practically all asset categories experienced decreases with loans receivable, accrued interest receivable and other receivables showing the most significant declines of \$263.7 million, \$7.6 million and \$11.7 million, respectively, over fiscal year 2016 ending balances; basically responding to the reduced role of the Bank since the enactment of Act no. 21 of 2016 (as amended by Act No. 2 of 2017) as being limited to just acting as an agent in (i) collecting and redeeming its loans and investment portfolios and (ii) disbursing funds pursuant to strict priority guidelines. The proportion of investments and investment contracts to total assets increased slightly to 8.26% in 2017 from 7.79% in 2016. Total liabilities decreased only by \$28 million or just 0.35%, remaining with minimal activity, also responding to the reduced role

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of the Bank and the enactment of Act No. 21 of 2016 and related executive order which placed a moratorium on the payment of most of the Bank's debt. With the enactment of the Puerto Rico, Oversight, Management and Economic Stability Act ("PROMESA") on June 30, 2016, through its Title VI (Qualifying Modification), practically all the Bank's debt and liabilities were eventually restructured through this Modification process executed on November 29, 2018. Details of the Qualifying Modification under Title VI of PROMESA is further discussed in Notes 3, 4 and 22.

Loans receivable of \$2,940 million, net of an allowance for loan losses of approximately \$5,976 million, shows a decrease of \$263.7 million or 8.23%, from fiscal 2016 to 2017. The allowance for loan losses at the Government-Wide level was impacted principally by a provision for loan losses during 2017 in the GDB Operating Fund in the amount of approximately \$108 million, offset by a release of approximately \$4 million and \$1 million during 2017 from the allowance for loan losses of the Puerto Rico Housing Finance Authority ("Housing Finance Authority") and the Tourism Development Fund, respectively; and the write-offs of approximately \$104 million in loans, \$102 million of which pertained to the GDB Operating Fund. Loans as a percentage of total assets decreased 2.00 percentage points from 82.8% at the end of fiscal year 2016 to 80.8% at June 30, 2017.

**(d) Governmental Activities**

Total assets of Governmental Activities amounted to approximately \$66.1 million at June 30, 2017. Total liabilities amounted to \$135.7 million, for a net deficit of \$69.7 million. Net deficit has been broken down into a net position invested in net capital assets of approximately \$1 thousand and the remaining balance as the unrestricted component of net deficit of approximately (\$69.7) million, which means that the use of available assets will not allow the Bank to satisfy its existing liabilities from those assets, and therefore, the Bank will depend on future Commonwealth appropriations for the repayment of part of its obligations. However, there is no assurance that the Legislative Assembly of the Commonwealth (the "Legislature") will authorize such appropriations in the future.

Condensed financial information on assets, liabilities and net position (deficit) of Governmental Activities as of June 30, 2017 and 2016, is shown below (in thousands):

	<u>June 30,</u>		<u>Change</u>	
	<u>2017</u>	<u>2016</u>	<u>Amount</u>	<u>Percent</u>
<b>Assets:</b>				
Cash and due from banks, and deposits placed with banks	\$ 18,749	\$ 13,705	\$ 5,044	37%
Investments and investment contracts	40,818	60,505	(19,687)	-33%
Other assets	6,508	8,646	(2,138)	-25%
Total assets	<u>66,075</u>	<u>82,856</u>	<u>(16,781)</u>	<u>-20%</u>
<b>Liabilities:</b>				
Accounts payable and accrued liabilities	10,370	14,158	(3,788)	-27%
Notes payable	3,336	3,334	2	0%
Total liabilities before internal balances	13,706	17,492	(3,786)	-22%
Internal balances	122,040	136,571	(14,531)	-11%
Total liabilities	<u>135,746</u>	<u>154,063</u>	<u>(18,317)</u>	<u>-12%</u>
<b>Net position (deficit):</b>				
Investment in capital assets	\$ 1	\$ 1	\$ -	0%
Unrestricted position (deficit)	(69,671)	(71,208)	1,537	-2%
Total net position (deficit)	<u>\$ (69,670)</u>	<u>\$ (71,207)</u>	<u>\$ 1,537</u>	<u>-2%</u>



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Investments and investment contracts amounted to \$40.8 million and, together with cash and due from banks and deposits placed with banks of \$18.7 million, account for the majority of the assets held by Governmental Activities. These assets are restricted to provide funds for the execution of the various affordable and other housing programs managed by the Housing Finance Authority. Other assets are mainly restricted and are composed mostly of amounts due from the U.S. Department of Housing and Urban Development (HUD) and the Investment Partnerships (HOME) federal programs. Accounts and accrued liabilities mainly consist of unpaid expenditures related to the HOME Program fund and of subsidies payable on various housing programs.

Condensed financial information on expenses, program revenues and changes in net position (deficit) of Governmental Activities during the years ended June 30, 2017 and 2016 is shown below (in thousands):

	<u>Year ended June 30, 2017</u>		
	<u>General</u>	<u>Housing</u>	
	<u>government</u>	<u>assistance</u>	<u>Total</u>
	<u>programs</u>		
Expenses	\$ 6,039	\$ 170,037	\$ 176,076
Program revenues:			
Charges for services – financing and investment	-	2,137	2,137
Operating grants and contributions	-	176,665	176,665
Net expenses	<u>\$ (6,039)</u>	<u>\$ 8,765</u>	<u>\$ 2,726</u>
Transfers-out, net			(1,190)
Change in net position (deficit)			1,536
Net position (deficit) – beginning of year (as restated)			(71,207)
Net position (deficit) – end of year			<u>\$ (69,671)</u>

	<u>Year ended June 30, 2016</u>		
	<u>General</u>	<u>Housing</u>	
	<u>government</u>	<u>assistance</u>	<u>Total</u>
	<u>programs</u>		
Expenses	\$ 24,381	\$ 190,011	\$ 214,392
Program revenues:			
Charges for services – financing and investment	-	4,076	4,076
Operating grants and contributions	-	184,521	184,521
Net expenses	<u>\$ 24,381</u>	<u>\$ (1,414)</u>	<u>\$ (25,795)</u>
Transfers-in			96,857
Change in net position (deficit)			71,062
Net position (deficit) – beginning of year			(142,269)
Net position (deficit) – end of year (as restated)			<u>\$ (71,207)</u>

**Governmental Activities Results**

Operating grants and contributions had a net decrease of \$7.8 million when compared to the prior year, from \$184.5 million in 2016 to \$176.7 million in 2017. The decrease is mainly related to the decrease in the grants and other income of the HOME Programs from \$29.2 million in fiscal year 2016 to \$18.2 million in fiscal year 2017. The decrease in the HOME Program grants is the result of decreased activity in construction projects subsidized by the program and also fiscal year 2016 was the

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last installment of the Voluntary Repayment Settlement Agreement with the U.S. Department of Housing and Urban Development (HUD), which accounted for \$5.1 million of other income in the previous year . The decrease in the HOME program grants was offset with an increase in Commonwealth appropriations of \$5.6 million from \$5.7 million in fiscal year 2016 to \$11.3 million in fiscal year 2017. The increase in Commonwealth's appropriations was due to additional funding received by My Own Program for the development of the Casa Mia Program and additional appropriations transferred for the operations of the Operating and Administrative Fund. There were net transfers out amounting to \$1.2 million in fiscal year 2017 compared to transfers in of \$ 96.9 million in fiscal year 2016 due to the fact that in fiscal year 2016 the operating and administrative fund sold loans and transferred \$89.3 million to My New Home Program for the payment of its line of credit in order to provide liquidity to the Bank. This transaction did not recur in 2017. The expenses of the Governmental Activities during fiscal year 2017 decreased by approximately \$38.3 million over fiscal year 2016, attributed to the same decreased activity in construction projects subsidized by the corresponding housing programs plus the effect of custodial credit losses on deposits held with the Bank and the Economic Development Bank for Puerto Rico (EDB) recognized in 2016 in the amount of approximately \$18.4 million versus none recognized during fiscal year 2017.

During 2017, the net deficit of the Governmental Activities decreased by \$1.5 million from a deficit of \$71.2 million at June 30, 2016, to a deficit of \$69.7 million at June 30, 2017, mainly related to the results for fiscal year, which saw its programs revenues exceeding its program expenses by approximately \$2.7 million, offset by the \$1.2 million net transfers out referred to in the previous paragraph.

An analysis of the financial position and results of operations of the Bank's major Governmental Funds follows:

(e) ***HUD Programs***

This fund accounts for the U.S. Housing Act Section 8 programs administered by the Housing Finance Authority under the authorization of the HUD. Presently, the Housing Finance Authority operates three programs whereby low-income families receive directly or indirectly subsidies to pay for their rent. The housing vouchers program enables families to obtain rental housing in a neighborhood of their choice. The other programs are project-based subsidies whereby housing developers are given incentives to keep their properties available for certain markets. The expenditures of the HUD programs increased \$1.5 million from approximately \$148.3 million in 2016 to approximately \$149.8 million in 2017 because additional vouchers were awarded when compared to the previous year. The net increase in cash and deposits placed with banks of approximately \$1.1 million, from \$444 thousands at June 30, 2016 to \$1.5 million at June 30, 2017, or 247.7%, correlates with a similar increase in liabilities of approximately \$1.2 million from \$1.4 million at June 30, 2016 to \$2.6 million at June 30, 2017, revealing the cash management being employed in the timing of payment of the program's liabilities, which depends on the timing of collection of funds from HUD, which receivable remained stable during the year. These changes are basically the result of the timing of requests of reimbursement from federal grants at each corresponding fiscal year.

(f) ***HOME Program***

This fund accounts for funds received from HUD for the administration of the HOME Program. The main purpose of this program is to increase the supply of decent and affordable housing for low and very low-income families. The net decrease in assets of approximately \$1.8 million, from \$8 million at June 30, 2016 to \$6.2 million at June 30, 2017, or 23%, mostly related to collection of funds due from HUD, correlates with a similar decrease in liabilities of \$1.9 million from \$8 million at June 30, 2016 to \$6.1 million at June 30, 2017; revealing the cash management being employed in the timing of payment of the program's liabilities, which depends on the timing of collection of funds from HUD. These changes are basically the result of the timing of requests of reimbursement from federal grants at each corresponding fiscal year.

Revenues decreased from approximately \$25.8 million in fiscal year 2016 to approximately \$16.1 million in fiscal year 2017 mainly due to the lower activity in construction projects subsidized by the program and a lower grant award and a decrease in other income, as fiscal year 2016 was the last year of the Voluntary Repayment Settlement Agreement with HUD, which accounted for \$5.1 million of other income, which did not recur in fiscal year 2017. Expenses decreased

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\$14.5 million in fiscal year 2017 to approximately \$14.7 million during fiscal year 2017 from \$29.2 million during fiscal year 2016, showing the same proportional decreases experienced in revenues, as expenditures on the program are tied to the funding that can be provided by HUD.

**(g) *Affordable Housing Mortgage Subsidy Programs***

Affordable Housing Mortgage Subsidy Programs ("AHMSP") Act No. 124 – This fund is used to account for the proceeds of specific local revenue sources under the different subsidy programs. Cash and deposits with commercial banks at June 30, 2017 and 2016 amounted in the aggregate to \$16.4 million and \$11.8 million, respectively; while investments and investment contracts at June 30, 2017 and 2016 amounted to \$40.8 million and \$60.5 million, respectively. These instruments combined reflect a net decrease of approximately \$16.1 million, mostly reflecting utilization of such funds for the funding and payment of the AHMSP program's liabilities.

The decrease of amounts due to other funds (representing amounts owed to the Bank under different lines of credit, repurchase agreements and for operating expenses advances) from \$135.1 million at June 30, 2016, to \$119.7 million at June 30, 2017, plus the decrease in accounts payable and accrued liabilities from \$7 million to \$3.8 million (a combined decrease of approximately \$18.6 million), was caused principally by the repayment of \$8.5 million to the Affordable Housing Mortgage Subsidy Program investment repurchase agreement, the repayment of \$11 million for amounts due to the operating and administrative fund and the repayment of approximately \$3 million in accounts payable. The source of funds for these repayments came from the decrease in the program's cash, investments and amounts due from HUD, as referred to in the previous paragraph.

Commonwealth appropriations during the year ended June 30, 2017 were \$11.3 million, an increase of approximately \$5.6 million from the \$5.7 million that were received during the year ended June 30, 2016. The increase in Commonwealth's appropriations was due to additional funding received by My Own Program for the development of the Casa Mia Program and additional appropriations of approximately \$5 million transferred for the operations of the Operating and Administrative Fund, which did not occur in 2016.

The expenditures of the AHMSP program during fiscal year 2017 decreased by approximately \$30.4 million over fiscal year 2016, attributed to decreased activity in construction projects subsidized by the corresponding housing programs plus the effect of custodial credit losses on deposits held with the Bank and EDB recognized in 2016 in the amount of approximately \$18.4 million versus none recognized during fiscal year 2017.

There were net transfers out amounting to \$1.2 million in fiscal year 2017 compared to transfers in of \$ 96.9 million in fiscal year 2016 due to the fact that in fiscal year 2016 the operating and administrative fund sold loans and transferred \$89.3 million to My New Home Program for the payment of its line of credit in order to provide liquidity to the Bank. This transaction did not recur in 2017.

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**Business-Type Activities**

Condensed financial information on assets, liabilities, deferred outflow of resources and net position (deficit) as of June 30, 2017 and 2016, is presented below (in thousands):

	June 30,		Change	
	2017	2016	Amount	Percent
<b>Assets:</b>				
Cash and due from banks	\$ 60,197	\$ 68,779	\$ (8,582)	-12.5%
Federal funds sold	158,764	87,256	71,508	82.0%
Deposits placed with banks	13,244	19,427	(6,183)	-31.8%
Investments and investment contracts	259,596	240,796	18,800	7.8%
Loans receivable – net	2,940,410	3,204,107	(263,697)	-8.2%
Accrued interest receivable	50,016	58,138	(8,122)	-14.0%
Real estate available for sale	59,940	61,957	(2,017)	-3.3%
Other receivable, net	3,068	14,224	(11,156)	-78.4%
Other assets	943	1,147	(204)	-17.8%
Internal balances	103,170	118,591	(15,421)	-13.0%
Capital assets	24,466	28,021	(3,555)	-12.7%
Total assets	<u>\$ 3,673,814</u>	<u>\$ 3,902,443</u>	<u>\$ (228,629)</u>	<u>-5.9%</u>
<b>Deferred outflow of resources:</b>				
Loss on bond refundings	2,151	2,376	(225)	-9.5%
Pension related	51,405	31,307	20,098	64.2%
Total deferred outflows of resources	<u>\$ 53,556</u>	<u>\$ 33,683</u>	<u>\$ 19,873</u>	<u>0.59%</u>
<b>Liabilities:</b>				
<b>Deposits:</b>				
Demand	\$ 1,492,247	\$ 1,635,942	\$ (143,695)	-8.8%
Certificates of deposit	1,722,875	1,783,540	(60,665)	-3.4%
Accrued interest payable	214,248	33,284	180,964	543.7%
Accounts payable, accrued liabilities, and other liabilities	270,837	268,594	2,243	0.8%
Unearned revenues	3,033	3,459	(426)	-12.3%
Net pension liability	203,367	170,330	33,037	19.4%
Bonds, notes and mortgage-backed certificates payable:				0.0%
Due in one year	977,108	707,633	269,475	38.1%
Due in more than one year	2,977,904	3,284,066	(306,162)	-9.3%
Total liabilities	<u>\$ 7,861,619</u>	<u>\$ 7,886,848</u>	<u>\$ (25,229)</u>	<u>-0.3%</u>
<b>Deferred inflow of resources-pension related</b>	<u>\$ 3,892</u>	<u>2,955</u>	<u>937</u>	<u>31.7%</u>
<b>Net position:</b>				
Net investment in capital assets	\$ 15,814	\$ 19,382	\$ (3,568)	-18.4%
<b>Restricted for:</b>				
Mortgage loan insurance	-	77,388	(77,388)	-100.0%
Affordable housing programs	26,060	30,456	(4,396)	-14.4%
Debt service	5,706	22,511	(16,805)	-74.7%
Other housing programs	6,163	4,755	1,408	29.6%
Unrestricted net position (deficit)	(4,191,884)	(4,108,169)	(83,715)	2.0%
Total net position (deficit)	<u>\$ (4,138,141)</u>	<u>\$ (3,953,677)</u>	<u>\$ (184,464)</u>	<u>4.7%</u>



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**(h) *Cash, Federal Funds Sold and Deposits Placed with Banks***

The Bank decreased its cash and due from banks by \$8.6 million from \$68.8 million at June 30, 2016 to \$60.2 million at June 30, 2017. Deposits placed with banks also decreased by \$6.2 million, from \$19.4 million at June 30, 2016 to \$13.2 million at June 30, 2017; however, federal funds sold experienced an increase of \$71.5 million from \$87.3 million at June 30, 2016 to \$158.8 million at June 30, 2017. With the Bank's reduced role solely to act as an agent in (i) collecting on its loan portfolio and (ii) disbursing funds pursuant to strict priority guidelines, all with the eventual evolution towards the orderly wind down of its operations, which was concluded on March 23, 2018 and the subsequent Qualifying Modification executed on November 29, 2018, most of its assets will be seen decreasing. However, the exception will be on certain financial instruments, in this case federal funds sold, which are the financial instruments being used at the moment to invest into all the collections, sales and redemption of assets being undertaken by the Bank, given their high liquidity and availability needed for the winding down process activities under way.

**(i) *Investments and Investment Contracts***

Investments and investment contracts held in Business-Type Activities amounted to \$259.6 million at June 30, 2017. This amount represents a net increase of \$18.8 million or 7.8% when compared to the prior year balance of \$241 million. This increase is principally attributed and triggered by a \$49 million increase in investments in the Puerto Rico Investment Trust Fund, which, as is also the case for the federal funds sold referred to in the previous section (h) above, are the investment instruments being used at the moment to accumulate into all the collections, sales and redemption of assets that are under way as part of the Bank's winding down process. Investments in the Puerto Rico Investment Trust Fund are highly liquid and represented 91% and 80% of the total investments held by the Bank with maturities within one year at June 30, 2017 and 2016, respectively. The rest of the investment portfolios has decreased in 2017.

The investment portfolio consisted primarily of highly liquid instruments such as external investments pools lead by the Puerto Rico Investment Trust Fund referred to in the previous paragraph, followed by U.S.-sponsored agency notes and mortgage-backed securities and nonparticipating investment contracts, all with very high credit ratings, reflecting the Bank's prudent and conservative investment policies. Most of the securities in the Bank's investment portfolio are AAA to A rated securities (around 97% of the total investment portfolio). The investment portfolio comprised 7% of the total assets of the Bank's Business-Type Activities at June 30, 2017, slightly up by less than 1% as compared to 6.1% at the close of fiscal year 2016. All of the Bank's investments in mortgage-backed securities amounting to \$81.5 million and \$102.2 million at June 30, 2017 and 2016, respectively, are held by trustees in connection with bonds issued by the Housing Finance Authority, the terms of which provide for early redemption of the bonds is the securities are repaid early.

**(j) *Loans Receivable, Allowance for Loan Losses and Liabilities under Guaranteed Obligations***

Net loans receivable decreased by \$263.7 million or 8.2%, from the \$3,204 million balance at June 30, 2016, to \$2,940 million at June 30, 2017, mainly as a result of the net effect of a reduction in gross balance of approximately \$264.4 million, including write-offs of public corporation and agencies loans of approximately \$102.4 million, and due to loan repayments within the public corporations and agencies (\$31.9 million), municipalities (\$110.4 million) and private loans portfolios (19.7 million); offset by a minimal net reduction on the allowance for loan losses of approximately \$0.7 million. On May 23, 2016, the amended approved budget of the Commonwealth included appropriations in an aggregate amount of approximately \$235 million, distributed through several items, segregated between approximately \$132.5 million cash appropriation that was required to be applied as payment of principal (\$21.3 million) and interest (\$111.2 million) of the Commonwealth's debts to the Bank; and approximately \$102.5 million appropriated for the operational and program needs of different components units of the Commonwealth and disbursed to those component units, but at the same time to be applied as a non-cash application to the principal of certain of the Commonwealth's lines of credit debt with the Bank (treated for accounting purposes as a write-off in fiscal year 2017 of loans that had been already fully reserved in previous years). The net reduction in the allowance for loan losses during fiscal year 2017 was caused by a combination of a net increase in the provision for loan losses of \$103.3 million (\$108.2 million increase in

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the provision of the public-sector loan portfolio of the GDB Operating Fund offset by an \$4.1 million and 0.7 million release in the provision of the Housing Finance Authority and Tourism Development loan portfolios, respectively) and net write-offs of \$104 million (\$102.4 million within the public and agency loans portfolio of the GDB Operating Fund and \$1.6 million within the private sector portfolio of the Housing Finance Authority). The Bank's basic role had been over the years to provide financing support to the Commonwealth and its public entities and municipalities and other operational needs. To support the governmental efforts of improving and stimulating Puerto Rico's economy, the Bank also used to finance the development and construction of infrastructure, housing projects and hotels as well as to guaranty loans and other obligations incurred by public and private entities. However, the continued deterioration in the Bank's financial condition and inability to repay its obligations prompted, among several remediation efforts, the reduction of the Bank's role to solely act as an agent in (i) collecting on its loan portfolio and (ii) disbursing funds pursuant to strict priority guidelines. As a result, the Bank's management concluded that an orderly wind down of its operations and a restructuring of its debt through the Qualifying Modification process would mitigate the impact on its stakeholders (municipalities, depositors, and other creditors, etc.). Refer to further details about these executed plans on Notes 3, 4 and 22.

The estimates for recording incurred losses in the loan portfolio involved significant management judgment based on observable facts and circumstances, mostly those related to the ultimate source of repayment. For example, the original source of repayment of many loans granted to the Commonwealth and agencies evolved around the capacity to bond out such loan in capital/municipal markets. In those cases, the original loan documents identified such vehicle to access liquidity. In the case of loans granted to public corporations, even when the operating results and/or debt appropriations served as the original source of repayment, the Commonwealth's limitations to timely provide for those payments were also considered by senior management.

The Bank considers the public-sector loan portfolio as impaired based on current information and events, including the significant delays in the receipt of the scheduled debt service payment mentioned above. In management's opinion, it is highly probable that the Bank will be unable to collect all amounts due according to the loan's original contractual terms. The Bank's management used applicable authoritative literature, general background information and recent relevant information included in the Commonwealth and Bank's fiscal plan to establish an allowance for loans losses. Specifically, the Bank established an allowance for losses on these impaired loans based on management's estimate of the present value of expected debt service payments discounted at the loans' effective interest rate. The Bank determined that major sources of repayment on this portfolio were property taxes, sales and use taxes, refinancing through bond issuances, appropriations from the Commonwealth, operating revenues of the borrowers, rental income generated by the borrowers, federal funding and collateral sales. To identify loans that must be individually measured for impairment, the population of all loans outstanding was segregated into three general portfolios based on groups of borrowers. (1) agencies and corporations, (2) municipalities, and (3) private sector loans. Agencies and corporations and municipalities portfolios were additionally segregated into risk-based buckets taking into consideration their source of repayment, guaranty and payment history. The risk based buckets included i) loans with a reliable source of repayment, ii) loans with an unreliable source of repayment that were not performing according to contract terms (as to principal and interest) and did not have any additional source of repayment, iii) loans with unreliable source of repayment that were not performing according to contract terms, but had real estate collateral as an additional source of repayment iv) loans with an unreliable source of repayment that were only paying interest and did not have any additional source of repayment, (v) loans with an unreliable source of repayment that were performing as to principal and interest, but did not have any additional source of repayment. For loans identified as those to be individually measured for impairment, resulting present value of estimated future cash flows was compared with the respective balance of the recorded investment in the loan to determine the impairment amount or required allowance for loan losses. For private loans, the most recent expected future cash flow expectations were used to determine required allowance for loan losses.

In relation to interest income recognition, for loans to public sector entities, the Bank classifies loans as nonaccrual when management determines if any of the following characteristics are present: (a) a loan was six months past due; (b) it had no current source of repayment; (c) it was not covered by a formal commitment from the Commonwealth; and (d) it did not have designated collateral or such collateral was insufficient. Based on these four elements, the loan was placed in nonaccrual status and all accrued interest receivable was reversed from interest income. Interest income on nonaccrual

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loans is thereafter recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when there is adequate evidence to believe that the loans will be performing as contracted.

As of June 30, 2017, the changes in the allowance for loan losses in the Proprietary Funds were as follows (in thousands):

	<b>Proprietary Funds</b>				<b>Total</b>
	<b>GDB</b>	<b>Tourism</b>	<b>Housing</b>	<b>Other</b>	
	<b>Operating</b>	<b>Development</b>	<b>Finance</b>		
<b>Fund</b>	<b>Fund</b>	<b>Authority</b>	<b>Non-major</b>		
Balance – beginning of year	\$ 5,842,467	\$ 73,696	\$ 34,258	\$ 26,800	\$ 5,977,221
Provision (release) of loan losses	108,157	(748)	(4,102)	-	103,307
Write-offs	(102,455)	-	(1,591)	-	(104,046)
Balance – end of year	<b>\$ 5,848,169</b>	<b>\$ 72,948</b>	<b>\$ 28,565</b>	<b>\$ 26,800</b>	<b>\$ 5,976,482</b>

Allowance for loan losses-collective loans

The provision for loan losses in the GDB Operating Fund includes approximately \$5.8 billion to provide for inherent credit losses of the public-sector loan portfolio, excluding municipal loans. The Bank calculated this allowance using risk characteristics in common with other impaired loans. The Bank evaluation of impaired loans consisted in identifying which public sector loans had reliable sources of repayment and which had unreliable sources of repayment. Loans with reliable sources of repayment were evaluated collectively. Loans with unreliable sources of repayment were evaluated for impairment individually. Impaired loans are measured individually based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral, if the loan was collateral dependent.

As previously discussed, working towards the closing date of the Qualifying Modification, which took place on November 29, 2018, the Bank reached several settlement agreements on some of its public sector and municipalities' loans, in addition to having received during fiscal year 2017 the last of the debt appropriations from the Legislature in the amount of \$235 million (\$132.5 million cash appropriations and \$102.5 million noncash appropriation) used to partially repay some of the loans issued to the Commonwealth. These settlement and repayment events, were factored into the current year's estimation, resulting in a allowance for public corporations and agencies loans of \$5,774 million at June 30, 2017.

Private Sector Loans

Private sector loans outstanding at June 30, 2017 and 2016 amounted to \$228.2 million and \$241.4 million, respectively, net of an allowance for loan losses of \$128.6 million and \$135.1 million at June 30, 2017 and 2016, respectively. Private sector loans mainly include loan facilities for the housing and tourism sectors through some component units of the Bank. Note that approximately only \$333 thousand of allowance for loan losses for private sector are accounted for under the GDB Operating Fund, while the greater part of the allowance is accounted under the Tourism Development Fund (\$72.9 million), the Housing Finance Authority (\$28.6 million) and the Development Fund (\$26.8 million). Refer to Note 8 to the basic financial statements for further information on loans receivable and allowance for loan losses.

Municipal Loans

Municipal loans outstanding at June 30, 2017 and 2016 amounted to \$2,129 million and \$2,236 million, respectively, net of an allowance for loan losses of \$73.4 million and \$77.4 million at June 30, 2017 and 2016, respectively. Municipal loans were provided mainly to finance capital expenditures.

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Liabilities under Guaranteed Obligations

Within accounts payable, accrued liabilities and liabilities under guaranteed obligations aggregating \$270.8 million and \$268.6 million at June 30, 2017 and 2016, respectively, the principal amount is attributed to the liabilities under guaranteed obligations of \$197.4 million and \$191.4 million at June 30, 2017 and 2016, respectively. As of June 30, 2017, the changes in such liabilities in the Proprietary Funds were as follows:

	<b>Beginning balance</b>	<b>Provision/ increases</b>	<b>Payments/ reductions/credits</b>	<b>Ending balance</b>	<b>Due within one year</b>
Tourism Development Fund	\$ 67,862,784	\$ 1,392,248	\$ (2,067,619)	\$ 67,187,413	\$ 19,000,000
Development Fund	1,993,108	-	(918,411)	1,074,697	-
GDB Operating Fund	113,929,000	6,445,000	-	120,374,000	-
Housing Finance Authority	7,669,619	1,799,503	(694,168)	8,774,954	8,774,954
Total	<u>\$ 191,454,511</u>	<u>\$ 9,636,751</u>	<u>\$ (3,680,198)</u>	<u>\$ 197,411,064</u>	<u>\$ 27,774,954</u>

The slight decrease in the corresponding liability of the Tourism Development Fund responds to discounted settlement agreements reached subsequent to fiscal year 2017 on several guarantees in exchange for the release of such claims, which were reflected in the estimation made as of June 30, 2017, offset by the related effect of the time value of money when compared to prior year's calculation. These settlement agreements consisted mostly in relieving its claims on the guarantees in exchange for discounted payoffs (as in the cases of the CGDP Hotel Condado Lagoon Hilton Villas II and the Embassy Suites Dorado del Mar guarantees) and a combination of discounted pay-offs and conversion of remaining obligations into Participating Bond Claims under the Qualifying Modification process, where such Participating Bond Claims were exchanged for New Bonds at the exchange rate of 55% (as in the case of the CCHPR Hospitality Sheraton Puerto Rico Hotel guaranty).

The activity during the year corresponding to the obligations guaranteed by the GDB Operating Fund included a settlement agreement reached after June 30, 2017 on the guaranty agreement of the Puerto Rico Ports Authority (PRIFA Revenue Bonds Series B), for which its effects were factored in into the determination of the updated liability as of June 30, 2017. The settlement agreement consisted mostly in relieving its claims under the guarantees in exchange for a conversion of remaining obligations into Participating Bond Claims under the Qualifying Modification process, where such Participating Bond Claims were exchanged for New Bonds at the exchange rate of 55%. The specific details about this settlement agreement are covered in Note 15 to the basic financial statements. The increase of \$6.4 million also included the related effect of the time value of money present value of discounted cash flows calculations when compared to prior year's calculation, with respect to the guaranty related to the Debt Service Deposit Agreement with Lehman Brothers guaranty.

The activity in the liability under the Housing Finance Authority responds to its mortgage loan insurance program where it guarantees up to \$75 million of the principal insured by such program. As of June 30, 2017, the mortgage loan insurance program covered loans aggregating to approximately \$571 million and for which an allowance of \$8.8 million was determined to be necessary as an estimate of the losses inherent in the portfolio, after a guaranty liability adjustment of \$694 thousands. Further details about the mortgage loan insurance program are explained in Note 14 to the basic financial statements.

(k) ***Accrued Interest Receivable***

Accrued interest receivable decreased by \$8.1 million or 14% from \$58.1 million at June 30, 2016 to \$50 million at June 30, 2017. Most of the loans receivable, specially within the public agencies and corporations' sector, are in non-accrual status and those loans within the Municipalities sector are also on a repayment mode as no new loans are being originated, which should maintain the related accrued interest balance either stable or decreasing.



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**(l) *Real Estate Available for Sale and Other Receivables***

During fiscal year 2009, the Bank entered into an interagency agreement with a public entity of the Commonwealth whereby the Bank received several properties with appraised values (based on appraisals made near the transaction date) of \$155.9 million in lieu of payment of a loan whose principal balance and accrued interest receivable amounted to approximately \$144.2 million at December 31, 2008. The interagency agreement provides that the agencies of the Commonwealth shall transfer to the Bank additional properties to cover any deficiency in the property values during a period of five years. On November 20, 2013, the agreement was extended until December 30, 2018. As part of such agreement, any subsequent loss or reduction of fair value shall be repaid by the Commonwealth or one of its component units. As of June 30, 2017, total receivable of \$75.2 million, related to the losses or reductions in fair value from the aforementioned properties, was considered uncollectible and fully reserved.

The decrease in the amount of real estate available for sale of \$2 million responds mostly to net effect of certain sales of real estate units and downward adjustments to the fair values of some others properties, which were already lower than its cost, for a combined total of \$4.1 million, offset by additional provisions for losses of \$2.1 million.

**(m) *Capital Assets***

Capital assets, net of accumulated depreciation, amortization and impairment, amounted to \$24.4 million at June 30, 2017, a decrease of \$3.5 million from the prior year, mostly attributed to the transfer of certain personal and real property with a carrying value of \$2.8 million to the Puerto Rico Art Museum pursuant the enactment of Act no. 29 of May 23, 2017, known as the Act for the Trust of the Puerto Rico Art Museum. Refer to Note 11 to the basic financial statements for additional information on capital assets.

**(n) *Deposits***

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

Demand deposits and certificates of deposit had a combined net decrease of \$204.4 million, from \$3,419 million at June 30, 2016 to \$3,215 million at June 30, 2017. This net decrease responds to the expected turnover of demand deposits considering their normally operational nature. Some of these demand deposits still experienced some uses and disbursements, even despite the restrictions imposed by Act No. 21, as amended; however, such uses continued to be lower than the previous year's reduction of \$404.7 million. Deposits represent approximately 41% and 43% of total liabilities at June 30, 2017 and 2016, respectively.

**(o) *Long-Term Debt***

The Housing Finance Authority redeemed several notes and bonds payable during fiscal year 2017 (no such redemptions or repayments by the GDB Operating Bank or the Tourism Development Fund), which explains the decrease of \$36.7 million or 0.92% over the prior year balance of \$3,992 million. There were no gross debt originations during the fiscal year ending June 30, 2017, while debt payments amounted to \$46.7 million, gross of approximately \$9 million in discount accretion.

Since fiscal year 2016 and after such date, there were various events of default on the repayment of principal and interest of long-term debt. For details please refer to Notes 4 and 22 to the basic financial statements.

The credit ratings of the Commonwealth and most of its public entities (including the Bank) were downgraded to non-investment grade categories since fiscal year ended June 30, 2015, and with respect to the Bank, Moody's Investors

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Service and Standard & Poor's Rating Services eventually lowered its credit rating to "D" after all the missed payments referred to in the previous paragraph.

(p) ***Puerto Rico Emergency Moratorium and Financial Rehabilitation Act***

On April 6, 2016, Governor Alejandro J. Garcia Padilla signed into law Act 21-2016, known as the "Puerto Rico Emergency Moratorium and Financial Rehabilitation Act" (as amended, "Act 21"). Act 21 allows the Governor, among other things, to stay debt service payments and to stay related creditor remedies for a temporary period for the Commonwealth and certain government instrumentalities in Puerto Rico, including the Bank. Act 21 also created the Puerto Rico Fiscal Agency and Financial Advisory Authority (the "FAFAA"), as an independent public corporation to assume the Bank's role as fiscal agent, financial advisor and reporting agent for the Commonwealth, its instrumentalities, and municipalities (Act 2-2017 subsequently repealed and replaced the provisions of Act 21 regarding FAFAA, as further disclosed in Note 3). FAFAA has also been assigned the tasks of overseeing matters related to the restructuring or adjustment of the Commonwealth's financial liabilities, coordinating liability management or other transactions with respect to such obligations, and ensuring compliance with fiscal plans and budgets approved by the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") pursuant to PROMESA. Refer to Note 3 to the basic financial statements, for details about PROMESA.

On April 8, 2016, the Governor signed Executive Order No. 2016-010 ("EO 10"), declaring the Bank to be in a state of emergency pursuant to Act 21. In accordance with the emergency powers provided for in Act 21, EO 10 implemented a regulatory framework governing the Bank's operations and liquidity, including prohibiting loan disbursements by the Bank and establishing a procedure with respect to governmental withdrawals, payments, and transfer requests with respect to funds held on deposit at the Bank. To that effect, EO 10 restricts the withdrawal, payment and transfer of funds held on deposit at the Bank to those reasonable and necessary to ensure the provision of essential services and authorizes the Bank to establish weekly limits on the aggregate amount of such disbursements. Moreover, EO 10 prohibits the Bank's depositors from printing or writing checks creditable against their accounts at the Bank, unless they obtain a temporary waiver from the Bank. Finally, pursuant to Act 21, EO 10 suspends Article 6 of Act No. 17 of September 23, 1948, as amended (the "Bank's Enabling Act"), the Bank is required to maintain a reserve of not less than 20% of its liabilities on accounts of deposits on demand.

On April 30, 2016, Governor Garcia Padilla signed Executive Order 2016-014 ("EO 14"), which, among other things, (a) designates deposits and letters of credit of the Bank as "enumerated obligations" of the Bank, thereby making them "covered obligations" of the Bank and, therefore, subject to the stay provisions of Act 21, (b) declares a moratorium with respect to the financial obligations of the Bank (other than deposits and interest obligations that may be paid in kind), (c) provides that interest payments in respect of the Bank's financial obligations may be made to the extent authorized by the Governor, and (d) declares an emergency period with respect to certain obligations of Puerto Rico Infrastructure Financing Authority (PRIFA) that are secured by a letter of credit issued by the Bank. Pursuant to EO 14, on May 1, 2016, the Bank failed to make a principal payment of approximately \$367 million in respect of its notes and has continued to default on debt service payment requirements scheduled during fiscal year 2017 and thereafter. For further details about such nonpayment of debt, please refer to Note 22(b).

As previously discussed, with the establishment of FAFAA, the Bank's role has been reduced solely to act as an agent in (i) collecting on its loan portfolio and (ii) disbursing funds pursuant to strict priority guidelines. Therefore, taking into consideration the scenario described above, given the reduced services that the Bank is currently providing and given that no appropriations were assigned to the Bank for fiscal year 2018, the Bank's management has concluded that an orderly wind down would mitigate the impact on its stakeholders (municipalities, depositors, and other creditors). As further discussed in Notes 3, 4 and 22 to the basic financial statements, part of this wind down process consists of Qualifying Modification consummated under Title VI of PROMESA on November 29, 2018.

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Condensed financial information on expenses, program revenues and changes in net position (deficit) for Business-Type Activities for the years ended June 30, 2017 and 2016, is presented below (in thousands):

Activity	Year ended June 30, 2017			
	Expenses	Program revenues		Net revenues/ (expenses)
		Charges for services		
		Fees, commissions, and others	Financing and investment	
GDB Operating Fund	\$ 413,614	\$ 2,474	\$ 239,257	\$ (171,883)
Housing Finance Authority	40,434	13,551	12,952	(13,931)
Tourism Development Fund	(174)	213	368	755
Other non-major funds	(858)	184	(1,637)	(595)
<b>Total</b>	<b>\$ 453,016</b>	<b>\$ 16,422</b>	<b>\$ 250,940</b>	<b>\$ (185,654)</b>
Transfers from governmental activities, net				1,190
Change in net position (deficit)				(184,464)
Net deficit – beginning of year, as restated				(3,953,677)
Net deficit – end of year				<b>\$ (4,138,141)</b>

Activity	Expenses	Charges for services		Net revenues/ (expenses)
		Fees, commissions, and others	Financing and investment	
		GDB Operating Fund	\$ 147,093	
Housing Finance Authority	124,282	13,676	25,189	(85,417)
Tourism Development Fund	3,872	3,755	2,008	1,891
Other non-major funds	(1,589)	359	244	2,192
<b>Total</b>	<b>\$ 273,658</b>	<b>\$ 23,647</b>	<b>\$ 268,661</b>	<b>\$ 18,650</b>
Transfers to governmental activities				(96,857)
Change in net position (deficit)				(78,207)
Net deficit – beginning of year				(3,875,470)
Net deficit – end of year, as restated				<b>\$ (3,953,677)</b>

**Proprietary Funds**

Following is a brief discussion of the most significant changes in the Bank's proprietary funds, not previously discussed. For more detailed information of the GDB Operating Fund refer to business-type activities section.

**GDB Operating Fund**

Net deficit increased from \$4,399.4 million at June 30, 2016 to a deficit of \$4,573.8 million at June 30, 2017. The increase in net deficit of approximately \$174.4 million in fiscal year 2017 is mostly attributed to provision for loan losses of approximately \$108 million and provision for losses in other accounts receivables of \$10 million.

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The operating results of the GDB Operating Fund worsened from an operating income of \$104.4 million during the fiscal year ended June 30, 2016 to an operating loss of \$170.3 million during the year ended June 30, 2017. This fluctuation is caused by the combination of a provision for loan losses of approximately \$108 million in 2017 when compared to a net release in the provision for loan losses of approximately \$208 million in fiscal year 2016 (a negative impact of approximately \$316 million) and increased salaries, fringe benefits and pension expenses in the amount of approximately \$15 million, offset by no custodial credit risk losses in 2017 when compared to approximately \$37 million in 2016, lower legal and professional fees in the amount of approximately \$23 million and lower provisions for losses in real estate owned and guaranty liabilities in the amount of approximately \$10 million.

Investment income in the GDB Operating Fund amounted to \$1.6 million in 2017, a decrease of \$6.5 million over the prior year. This decrease responds practically in its entirety to the interest and dividend income in the deposits and investment and investment contracts portfolio, which in average has continued to decrease as a result of the reduced role of the Bank in the process of the winding down of its operations.

Interest income on loans in the GDB Operating Fund amounted to \$237.7 million in 2017, an increase of approximately \$4.5 million over the prior year. This net increase responds mostly to an increase in the actual collection of interest income on non-accruing loans over the prior year's collection of interest on the same type of loans, slightly offset by lower accrual of interest income during 2017 as a result of a reduced volume of agencies and public corporation loans in accruing status as compared to prior year and a decreasing municipal loans portfolio. During 2017, the actual collection of interest income on non-accruing loans amounted to approximately \$120.7 million as compared with actual collection of interest income on non-accruing loans in 2016 amounting to approximately \$113 million. This actual collection of \$120.7 million of interest income in non-accruing loans is the result of the collection of approximately \$111.2 million of interest income and \$21.3 million of principal on non-accruing loans from the Commonwealth, as a result of the approved Commonwealth's budget for fiscal year 2017 which provided for appropriations of approximately \$132.5 million required to be applied as payment of principal and interest of the Commonwealth's debts to the Bank. In addition to the aforementioned \$111.2 interest income collection, another set of non-accruing loans from certain other public corporations also received collection of interest in the amount of approximately \$9.5 million, for a combined total collection of \$120.7 million of interest income as compared with collection of interest income on non-accruing loans in 2016 amounting to approximately \$113 million. There was also a reduction of approximately \$359,000 in interest income from municipal loans, responding mostly to the decreases in the municipal loans' portfolio for the current year, which experienced a reduction in its outstanding balance of approximately \$107 million.

#### **Housing Finance Authority**

Net position of the Housing Finance Authority decreased by \$10 million from \$213 million at June 30, 2016 to \$203 million at June 30, 2017, attributed by an operating loss \$6 million coupled with a net loss on sale of loans of almost \$5 million.

An analysis of the statement of net position reveals a decrease in investments and investment contracts amounting to \$28 million and a decrease in loans receivable in the amount of \$13 million, for a combined decrease of almost \$41 million. The decrease in loans receivable is principally the result of the sale of the mortgage loans referred to in the previous paragraphs. The proceeds from such sales plus the cash inflows produced by the net reduction in investment and investment contracts assisted in meeting the scheduled payments of long-term debt which amounted to approximately \$47 million during the fiscal year 2017. Cash and deposits placed with banks increased by \$8 million, as compared to prior year's decrease of \$166 million, which is principally due to the custodial credit risk loss recognized during 2016 in the amount of almost \$182 million (none during fiscal year 2017).

#### **Tourism Development Fund**

Net deficit of the Tourism Development Fund increased by \$575 thousands from \$55.2 million at June 30, 2016 to a \$55.8 million deficit at June 30, 2017, mostly caused by the combination of additional custodial credit losses of almost \$1.3 million, offset by a release in the provision for loan losses during the year of approximately \$747 thousands.



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The Tourism Development Fund's operations during fiscal year 2017 was minimal, which explains the decrease in assets of just \$255 thousands and the net increase in liabilities of only \$321 thousands; mostly attributed to recalculations for the year of the allowance for loan losses and expected discounted cash flow payments of guarantees.

### Going Concern Uncertainty

Management believes that there is substantial doubt about the Bank's ability to continue as a going concern because of the following:

- The Bank traditionally served as interim lender to the Commonwealth and its public corporations (also referred to herein as instrumentalities) and municipalities in anticipation of the issuance of long-term bonds and notes by such entities in the municipal bond market. The Bank has also provided financing to the Commonwealth and its instrumentalities to finance their respective budget deficits, collateral requirements under swap agreements and to meet mandatory payments of obligations. As a result, the Bank's liquidity and financial condition depends to a large extent on the repayment of loans made to the Commonwealth and its instrumentalities. The Commonwealth and its instrumentalities are in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. Conditions that adversely affect the ability of the Commonwealth and its instrumentalities to raise cash (including limited access to capital markets) and repay their interim and other loans to the Bank have an adverse effect on the Bank's liquidity and financial condition.
- On March 23, 2018, the Bank ceased its operations and determined to wind down in an orderly fashion under Title VI of PROMESA. Refer to Note 4 to the basic financial statements for details about PROMESA.
- As previously discussed, on April 6, 2016, Governor Alejandro J. Garcia Padilla signed into law Act 21-2016, known as the Moratorium Act. Act 21, among other things, created FAFAA, as an independent public corporation to assume the Bank's role as fiscal agent, financial advisor and reporting agent for the Commonwealth, its instrumentalities, and municipalities (Act 2-2017 subsequently repealed and replaced the provisions of Act 21 regarding FAFAA, as further disclosed in Note 3 to the basic financial statements).

Upon the establishment of FAFAA, GDB's role was reduced to act as an agent in (i) collecting on its loans portfolio and (ii) disbursing funds pursuant to strict priority guidelines. Therefore, taking into consideration the scenario described above, given the reduced services that the Bank was then providing and given that no appropriations were assigned to the Bank for fiscal years 2018 and 2019, the Bank's management initiated an orderly wind down process and debt restructuring pursuant to Title VI of PROMESA. Details of the Qualifying Modification under Title VI of PROMESA (the Qualifying Modification) is further discussed in Note 22.

### Currently Known Facts and Events

#### *Qualifying Modification and the Title VI Approval Process*

On November 29, 2018, the Bank completed a restructuring of certain of its indebtedness pursuant to a Qualifying Modification under Title VI of PROMESA (the Qualifying Modification). Under the Qualifying Modification, holders of the GDB Senior Notes and certain deposit claims against the Bank (each a Participating Bond Claim) exchanged their claims for bonds (at an upfront exchange ratio of 55%) issued by a newly created public instrumentality—the GDB Debt Recovery Authority created under Act No. 109 of August 24, 2017, known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the GDB Restructuring Act)—and the Bank transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash. In addition, pursuant to the GDB Restructuring Act, claims on account of deposits held by the Commonwealth and other public entities were exchanged for interest in a newly formed trust created pursuant to the GDB Restructuring Act, titled the Public Entity Trust (the PET).

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On November 6, 2018, the United States District Court for the District of Puerto Rico approved the Qualifying Modification pursuant to section 601(m)(2) of PROMESA, and the Qualifying Modification became effective as of November 29, 2018. Pursuant to PROMESA, the Qualifying Modification is valid and binding on any person or entity asserting claims or other rights, including a beneficial interest (directly or indirectly, as principal, agent, counterpart, subrogee, insurer or otherwise) in respect of Participating Bond Claims, and any trustee, any collateral agent, any indenture trustee, any fiscal agent, and any bank that receives or holds funds related to such Participating Bonds. The Qualifying Modification, including all settlements, compromises, releases, discharges, and injunctions, were deemed by the District Court to be full, final, complete, binding, and conclusive as to the Commonwealth, all Commonwealth instrumentalities, and any creditors of such entities, and shall not be subject to any collateral attack or other challenge by any such entities in any court or other forum.

Under the GDB Restructuring Act, the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates (each a Non-Municipal Government Entity) and the Bank were determined by applying the outstanding balance of any deposits held at the Bank in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to the Bank or of any bond or note of such Non-Municipal Government Entity held by the Bank as of such date. Those Non-Municipal Government Entities having net claims against the Bank, after giving effect to the foregoing adjustment received their pro rata share of interests in the PET, which was deemed to be full satisfaction of any and all claims such Non-Municipal Government Entity may have against the Bank.

The assets of the PET (the PET Assets) consist of, among other items, an unsecured claim of \$578 million, which is the subject of a proof of claim filed in the Commonwealth's Title III case (the PET Claim). Non-Municipal Government Entities' recoveries on account of their interests in the PET will depend upon the recovery ultimately received by the PET on account of the PET Assets. The Official Committee of Unsecured Creditors appointed in the Commonwealth Title III Case has objected to the PET Claim and, as of the date hereof, the Court has not determined if the PET Claim is an allowed claim that will be entitled to a distribution. Claims that the Commonwealth and other governmental entities may have had against the Bank have been released pursuant to the GDB Restructuring Act.

***PayGo Pension Reform***

On June 27, 2017, the Treasury Department issued Circular Letter No. 1300-46-17 to convey to the central government agencies, public corporations and municipalities the new implementation procedures to adopt, effective July 1, 2017, a new "pay-as-you-go" (PayGo) system. With the start of fiscal year 2018, employers' contributions, contributions ordered by special laws, and the Additional Uniform Contribution were all eliminated.

The PayGo system was one component of Act No. 106 of 2017 (Act 106-2017), which the Governor signed into law on August 23, 2017. Act 106-2017 created the legal framework so that the Commonwealth can guarantee benefit payments to current pensioners through the PayGo system. Approximately \$2 billion was allocated for these purposes in each of the budgets for fiscal year 2018 and fiscal year 2019. Act 106-2017 also created a Defined Contributions Plan, similar to a 401(k) plan, that will be managed by a private entity. Future benefits will not be paid by any of the retirement systems of the Commonwealth.

Act 106-2017, among other things, amended Act No. 12 with respect to the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico's (ERS) governance, funding and benefits for active members of the actual program and new hired members. Under Act 106-2017, ERS's board of trustees was eliminated and a new Retirement Board was created. The Retirement Board is currently responsible for governing both ERS and the Judiciary Retirement System (JRS).

Act 106-2017 terminated the previously existing pension programs for ERS participants as of June 30, 2017. The members of the prior programs and new system members hired on and after July 1, 2017 will be enrolled in a new defined contributions program that will be selected by the Retirement Board. The accumulated balance on the accounts of the prior program will be transferred to the member accounts in the new defined contributions program. ERS' active members of the defined contributions program will retain their benefits as stated under Act 91 of March 29, 2003.

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Act 106-2017 also ordered a suspension of ERS's loan programs and ordered a merger of the administrative structures of the retirement systems. At the Retirement Board's discretion, the administration of ERS benefits may be externalized. The employees of ERS that are not retained under the new administrative structure will be transferred to other public agencies in conformity with Act No. 8 of February 8, 2017. In addition, Act 106-2017 repealed the Voluntary Early Retirement Law, Act No. 211 of 2015, while creating an incentives, opportunities and retraining program for public workers.

### ***Proposed Title III Joint Plan of Adjustment for the Commonwealth, ERS and Public Building Authority (PBA)***

On September 27, 2019, the Oversight Board—as representative of the Commonwealth, the System and PBA in their respective Title III cases—filed its initial joint Title III plan of adjustment for the Commonwealth, the System, and PBA [ECF No. 8765] (the Initial Plan) along with a disclosure statement related thereto [ECF No. 8765] (the Initial Disclosure Statement). On February 9, 2020, the Oversight Board announced that it entered into a plan support agreement (the PSA) with certain Commonwealth general obligation bondholders and PBA bondholders, which would require revisions to the Initial Plan. On February 28, 2020, the Oversight Board filed its *Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al.* [ECF No. 11946] (the Amended Plan) and an amended disclosure statement related thereto [ECF No. 11947] (the Amended Disclosure Statement), which revised the Initial Plan to conform to the PSA. On March 10, 2020, the Title III Court granted the Oversight Board's motion to schedule a hearing for June 3, 2020 to consider the adequacy of the Amended Disclosure Statement. The deadline to file any objections to the Amended Disclosure Statement is April 24, 2020, and the Oversight Board's reply deadline is May 20, 2020. In addition, the Title III Court has reserved the period from October 21, 2020 through November 6, 2020 for the confirmation hearing on the Amended Plan. The Amended Plan and Amended Disclosure Statement remain subject to future amendments and Title III Court approval, and it is not certain that the Title III Court will ultimately confirm the Amended Plan.

For further information, please refer to the publicly available Amended Plan and Amended Disclosure Statement, available at <https://cases.primeclerk.com/puertorico/Home-DocketInfo>.

### ***Puerto Rico Housing Finance Authority***

As part of the efforts of the Government of Puerto Rico to maximize resources through consolidation of governmental structures in order to achieve greater levels of efficiency, the Governor of Puerto Rico informed the U.S. Department of Housing and Urban Development the transfer of the HOME Program from the Puerto Rico Housing Finance Authority to the Puerto Rico Department of Housing. Such transfer was effective on March 1, 2019.

On January 6 and 7, 2020, Puerto Rico sustained a series of strong earthquakes, which caused significant damages to individual and family housing as well as to public schools and small businesses, predominantly concentrated in several municipalities in the southwestern part of the island. These earthquakes have been followed by hundreds of aftershocks that have continued to recur through the date of these financial statements. Management has not identified yet the impact, if any, that these earthquakes may have on the Puerto Rico Housing Finance Authority's programs or operations. Through the date of these financial statements, no claims have been made or received through the Puerto Rico Housing Finance Authority's mortgage loan insurance programs.

### ***Coronavirus Pandemic***

On March 11th, 2020, the World Health Organization declared the Coronavirus disease ("COVID-19") as a global pandemic. As a result of the health threat and to contain the virus spread across the island, Governor Vázquez-Garced issued executive order EO 2020-020, on March 12, 2020, declaring a state of emergency in Puerto Rico to concentrate all efforts and implement necessary measures to safeguard the health, well-being and public safety of the citizens of Puerto Rico. The executive order authorizes the Commonwealth's Secretary of the Treasury and the Executive Director of the PROMB to set up a special budget, from any available funds, including the Emergency Fund, to cover all necessary costs for the containment of the virus throughout the island and sharing information with the municipalities. Subsequent executive orders, including curfew directives and other protective measures have been issued in response to the COVID-19 spread. Also, economic stabilization measures have been implemented by both the Government of Puerto Rico and the U.S. Government to provide support and stimulus to frontline workers, educators and students, hospitals and small businesses, including individuals and businesses in Puerto Rico, in response to the economic distress caused by the COVID-19 pandemic.

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**Contacting the Bank's Financial Management**

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

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**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
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**STATEMENT OF NET POSITION (DEFICIT)**  
**JUNE 30, 2017**

	Governmental Activities	Business- type Activities	Total
<b>ASSETS:</b>			
Cash and due from banks	\$ 18,404,816	\$ 60,197,300	\$ 78,602,116
Federal funds sold	—	158,764,462	158,764,462
Deposits placed with banks	343,718	13,243,538	13,587,256
Due from federal government, net	6,361,526	—	6,361,526
Investments and investment contracts	40,817,579	259,595,910	300,413,489
Loans receivable, net	—	2,940,409,787	2,940,409,787
Accrued interest receivable	147,007	50,016,059	50,163,066
Real estate available for sale	—	59,940,464	59,940,464
Capital assets:			
Land and other nondepreciable assets	—	23,452,712	23,452,712
Other capital assets	589	1,012,740	1,013,329
Other receivables, net	—	3,068,484	3,068,484
Other assets	—	943,226	943,226
Total assets	<u>66,075,235</u>	<u>3,570,644,682</u>	<u>3,636,719,917</u>
<b>DEFERRED OUTFLOW OF RESOURCES:</b>			
Loss on bond refundings	—	2,151,387	2,151,387
Pension related	—	51,404,424	51,404,424
Total deferred outflow of resources	<u>—</u>	<u>53,555,811</u>	<u>53,555,811</u>
<b>LIABILITIES:</b>			
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:			
Demand	—	1,492,246,792	1,492,246,792
Certificates of deposit	—	1,722,874,995	1,722,874,995
Accrued interest payable	260,029	214,248,817	214,508,846
Accounts payable and accrued liabilities:			
Due within one year	10,109,959	48,656,837	58,766,796
Due in more than one year	—	24,769,428	24,769,428
Internal balances	122,039,777	(103,170,171)	18,869,606
Mortgage loan insurance and liabilities under guaranteed obligations:			
Due within one year	—	27,774,954	27,774,954
Due in more than one year	—	169,636,110	169,636,110
Unearned revenues	—	3,032,327	3,032,327
Participation agreement payable:			
Due within one year	—	1,877,778	1,877,778
Due in more than one year	—	20,077,778	20,077,778
Bonds, notes and mortgage-backed certificates payable:			
Due within one year	170,073	975,230,477	975,400,550
Due in more than one year	3,166,185	2,957,826,117	2,960,992,302
Net pension liability	—	203,366,767	203,366,767
Total liabilities	<u>135,746,023</u>	<u>7,758,449,006</u>	<u>7,894,195,029</u>
<b>DEFERRED INFLOW OF RESOURCES - PENSION RELATED</b>	<u>—</u>	<u>3,892,290</u>	<u>3,892,290</u>
<b>NET POSITION (DEFICIT):</b>			
Net invested in capital assets	589	15,814,445	15,815,034
Restricted for:			
Affordable housing programs	—	26,060,393	26,060,393
Debt service	—	5,705,711	5,705,711
Other housing programs	—	6,162,742	6,162,742
Unrestricted net deficit	(69,671,377)	(4,191,884,094)	(4,261,555,471)
<b>TOTAL NET DEFICIT</b>	<u>\$ (69,670,788)</u>	<u>\$ (4,138,140,803)</u>	<u>\$ (4,207,811,591)</u>

See accompanying notes to basic financial statements.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
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**STATEMENT OF ACTIVITIES**  
**YEAR ENDED JUNE 30, 2017**

	Expenses	Program Revenues			Net Revenues (Expenses) and Changes in Net Position (Deficit)		Total
		Charges for Services - Fees, Commissions, and Others	Charges for Services - Financing and Investment	Operating Grants and Contributions	Governmental Activities	Business-type Activities	
<b>FUNCTIONS/PROGRAMS:</b>							
<b>Governmental activities:</b>							
General government and other	\$ 6,039,034	\$ —	\$ —	\$ —	\$ (6,039,034)	\$ —	\$ (6,039,034)
Housing assistance programs	170,036,699	—	2,136,602	176,664,788	8,764,691	—	8,764,691
Total governmental activities	<u>176,075,733</u>	<u>—</u>	<u>2,136,602</u>	<u>176,664,788</u>	<u>2,725,657</u>	<u>—</u>	<u>2,725,657</u>
<b>Business-type activities:</b>							
GDB Operating Fund	413,614,152	2,473,901	239,257,607	—	—	(171,882,644)	(171,882,644)
Housing Finance Authority	40,434,685	13,551,420	12,952,396	—	—	(13,930,869)	(13,930,869)
Tourism Development Fund	(173,595)	212,750	368,234	—	—	754,579	754,579
Other non-major	(858,121)	183,884	(1,636,980)	—	—	(594,975)	(594,975)
Total business-type activities	<u>453,017,121</u>	<u>16,421,955</u>	<u>250,941,257</u>	<u>—</u>	<u>—</u>	<u>(185,653,909)</u>	<u>(185,653,909)</u>
Total	<u>\$ 629,092,854</u>	<u>\$ 16,421,955</u>	<u>\$ 253,077,859</u>	<u>\$ 176,664,788</u>	<u>2,725,657</u>	<u>(185,653,909)</u>	<u>(182,928,252)</u>
<b>TRANSFERS IN (OUT) — Net</b>					<u>(1,189,643)</u>	<u>1,189,643</u>	<u>—</u>
<b>CHANGES IN NET POSITION (DEFICIT)</b>					<u>1,536,014</u>	<u>(184,464,266)</u>	<u>(182,928,252)</u>
<b>NET DEFICIT — Beginning of year (as restated, see Note 5)</b>					<u>(71,206,802)</u>	<u>(3,953,676,537)</u>	<u>(4,024,883,339)</u>
<b>NET DEFICIT — End of year</b>					<u>\$ (69,670,788)</u>	<u>\$ (4,138,140,803)</u>	<u>\$ (4,207,811,591)</u>

See accompanying notes to basic financial statements.



**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
**(A Component Unit of the Commonwealth of Puerto Rico)**  
**BALANCE SHEET — GOVERNMENTAL FUNDS**  
**JUNE 30, 2017**

	HUD Programs	Home Program	Affordable Housing Mortgage Subsidy Program	Total Governmental Funds
<b>ASSETS:</b>				
<b>Restricted:</b>				
Cash and due from banks	\$ 1,495,202	\$ 897,546	\$ 16,012,068	\$ 18,404,816
Deposits placed with banks	—	—	343,718	343,718
Due from federal government	1,048,108	5,313,418	—	6,361,526
Investments and investment contracts	—	—	40,817,579	40,817,579
Interest and other receivables	23,893	—	123,114	147,007
Total assets	<u>\$ 2,567,203</u>	<u>\$ 6,210,964</u>	<u>\$ 57,296,479</u>	<u>\$ 66,074,646</u>
<b>LIABILITIES PAYABLE FROM RESTRICTED ASSETS:</b>				
Due to other funds	\$ 2,062,804	\$ 318,153	\$ 119,658,820	\$ 122,039,777
Accounts payable and accrued liabilities	504,399	5,788,520	3,817,040	10,109,959
Matured principal on appropriation note	—	—	83,595	83,595
Matured interest payable	—	—	189,783	189,783
Total liabilities	<u>2,567,203</u>	<u>6,106,673</u>	<u>123,749,238</u>	<u>132,423,114</u>
Deferred inflows of resources - Intergovernmental grants	—	2,073,157	—	2,073,157
<b>FUND DEFICIT:</b>				
Unassigned	—	(1,968,866)	(66,452,759)	(68,421,625)
Total fund deficit	—	(1,968,866)	(66,452,759)	(68,421,625)
Total liabilities and fund deficit	<u>\$ 2,567,203</u>	<u>\$ 6,210,964</u>	<u>\$ 57,296,479</u>	<u>\$ 66,074,646</u>

See accompanying notes to basic financial statements.



**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
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**RECONCILIATION OF THE BALANCE SHEET—GOVERNMENTAL FUNDS TO THE STATEMENT OF NET POSITION (DEFICIT)**  
**JUNE 30, 2017**

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Amounts reported for governmental activities in the statement of net position (deficit) are different because:

Total fund deficit	(68,421,625)
Capital assets used in governmental activities are not financial resources and therefore, are not reported in the funds	589
Bonds and notes payable are not due and payable in the current period and therefore, are not reported in the funds	(3,252,663)
Accrued interest payable is not due and payable in the current period; therefore, is not reported in the funds	(70,246)
Deferred inflow of resources reported in the governmental funds are recognized as revenue in the governmental activities	2,073,157
Net deficit of governmental activities	<u>\$ (69,670,788)</u>

See accompanying notes to basic financial statements.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) — GOVERNMENTAL FUNDS  
YEAR ENDED JUNE 30, 2017**

	HUD Programs	Home Program	Affordable Housing Mortgage Subsidy Program	Total Governmental Funds
<b>REVENUES:</b>				
Commonwealth appropriation for operations and housing assistance programs	\$ —	\$ —	\$ 11,261,111	\$ 11,261,111
Intergovernmental – federal government	149,784,767	16,025,276	—	165,810,043
Interest income on deposits placed with banks	—	—	6,963	6,963
Interest income on investments	—	—	2,336,757	2,336,757
Net decrease in fair value of investments	—	—	(200,155)	(200,155)
Other	4,208	101,119	830,359	935,686
Total revenues	<u>149,788,975</u>	<u>16,126,395</u>	<u>14,235,035</u>	<u>180,150,405</u>
<b>EXPENDITURES:</b>				
General government and other	4,874,323	875,133	288,845	6,038,301
Housing assistance programs	144,914,652	13,797,956	11,131,903	169,844,511
Debt service				
Principal	—	—	83,595	83,595
Interest	—	—	189,783	189,783
Total expenditures	<u>149,788,975</u>	<u>14,673,089</u>	<u>11,694,126</u>	<u>176,156,190</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	—	1,453,306	2,540,909	3,994,215
<b>OTHER FINANCIANG USES - net transfers-out</b>	—	—	(1,189,643)	(1,189,643)
<b>NET CHANGES IN FUND BALANCES (DEFICIT)</b>	—	1,453,306	1,351,266	2,804,572
<b>FUND DEFICIT — Beginning of year (as restated, see Note 5)</b>	—	(3,422,172)	(67,804,025)	(71,226,197)
<b>FUND DEFICIT — End of year</b>	<u>\$ —</u>	<u>\$ (1,968,866)</u>	<u>\$ (66,452,759)</u>	<u>\$ (68,421,625)</u>

See accompanying notes to basic financial statements.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
**(A Component Unit of the Commonwealth of Puerto Rico)**  
**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUNDS BALANCES-**  
**GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**  
**YEAR ENDED JUNE 30, 2017**

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Amounts reported for governmental activities in the statement of net position are different because:	
Net change in fund balances (deficit) - total governmental funds	\$ 2,804,572
Some expenses in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds	(2,644)
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources. These amounts are the net effect of these differences in the treatment of long-term debt and related items as follows:	
Principal on appropriation note - matured	83,595
Decrease in interest accrued payable on appropriation note	239
Some intergovernmental revenue in the statement of activities do not provide current financial resources, and therefore, are deferred in the governmental funds. Also, intergovernmental revenue related to prior periods that became available during the current period is reported in the governmental funds but is eliminated in the statement of activities. This amount is the net adjustment.	(1,349,015)
Revenues in the statement of activities that do provide current financial resources are not reported as revenue in the funds. This is the amount by which depreciation exceeded capital outlays in the current period.	(733)
Change in net position of governmental activities	<u>\$ 1,536,014</u>

See accompanying notes to basic financial statements.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
**(A Component Unit of the Commonwealth of Puerto Rico)**  
**STATEMENT OF NET POSITION (DEFICIT) — PROPRIETARY FUNDS**  
**JUNE 30, 2017**

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Other Non-major	Eliminations	Total
<b>ASSETS</b>						
<b>CURRENT ASSETS:</b>						
Cash and due from banks	\$ 10,179,197	\$ 39,212,506	\$ 6,492	\$ —	\$ (752,533)	\$ 48,645,662
Federal funds sold	158,764,462	—	—	—	—	158,764,462
Deposits placed with banks	2,198,726	—	—	—	—	2,198,726
Investments and investment contracts	104,012,929	—	—	—	—	104,012,929
Loans receivable — net	134,145,346	1,044,215	3,589,500	—	—	138,779,061
Accrued interest receivable	48,547,131	1,107,315	19,556	—	(355)	49,673,647
Other current receivables	1,236,895	1,713,449	—	—	—	2,950,344
Other current assets	612,185	41,257	—	—	—	653,442
Due from governmental funds	90,922,093	12,248,078	—	—	—	103,170,171
Restricted:						
Cash and due from banks	—	11,551,638	—	—	—	11,551,638
Investments and investment contracts	—	10,583,792	—	—	—	10,583,792
Loans receivable — net	—	893,840	—	—	—	893,840
Accrued interest receivable	—	342,412	—	—	—	342,412
Other current receivables	—	118,140	—	—	—	118,140
<b>Total current assets</b>	<b>550,618,964</b>	<b>78,856,642</b>	<b>3,615,548</b>	<b>—</b>	<b>(752,888)</b>	<b>632,338,266</b>
<b>NON-CURRENT ASSETS:</b>						
Restricted:						
Deposits placed with banks	—	11,044,812	—	—	—	11,044,812
Investments and investment contracts	—	115,624,629	—	—	—	115,624,629
Loans receivable — net	—	59,331,997	—	—	—	59,331,997
Real estate available for sale	—	2,779,004	—	—	—	2,779,004
Investments and investment contracts	—	27,638,653	33,042	1,702,865	—	29,374,560
Loans receivable — net	2,578,618,569	131,761,203	31,025,117	—	—	2,741,404,889
Real estate available for sale	57,057,752	103,708	—	—	—	57,161,460
Capital assets:						
Land and other non-depreciable assets	14,100,000	9,352,712	—	—	—	23,452,712
Other capital assets	414,735	598,005	—	—	—	1,012,740
Other assets	—	—	289,784	—	—	289,784
<b>Total non-current assets</b>	<b>2,650,191,056</b>	<b>358,234,723</b>	<b>31,347,943</b>	<b>1,702,865</b>	<b>—</b>	<b>3,041,476,587</b>
<b>Total assets</b>	<b>\$ 3,200,810,020</b>	<b>\$ 437,091,365</b>	<b>\$ 34,963,491</b>	<b>\$ 1,702,865</b>	<b>\$ (752,888)</b>	<b>\$ 3,673,814,853</b>
<b>DEFERRED OUTFLOW OF RESOURCES:</b>						
Loss on bond refundings	—	2,151,387	—	—	—	2,151,387
Pension related	39,300,390	12,104,034	—	—	—	51,404,424
<b>Total deferred outflow of resources</b>	<b>\$ 39,300,390</b>	<b>\$ 14,255,421</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 53,555,811</b>

See accompanying notes to basic financial statements.

(Continued)

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
**(A Component Unit of the Commonwealth of Puerto Rico)**  
**STATEMENT OF NET POSITION (DEFICIT) — PROPRIETARY FUNDS**  
**JUNE 30, 2017**

	<b>GDB Operating Fund</b>	<b>Housing Finance Authority</b>	<b>Tourism Development Fund</b>	<b>Other Non-major</b>	<b>Eliminations</b>	<b>Total</b>
<b>LIABILITIES</b>						
Current liabilities:						
Deposits, principally from the Commonwealth of Puerto Rico and its public entities:						
Demand	\$ 1,512,569,802	\$ —	\$ —	\$ —	\$ (20,323,010)	\$ 1,492,246,792
Certificates of deposit	1,990,313,250	—	—	—	(267,438,255)	1,722,874,995
Accrued interest payable	214,423,807	—	826,354	—	(1,009,521)	214,240,640
Accounts payable and accrued liabilities	40,192,491	7,144,683	747,802	249,290	—	48,334,266
Participation agreement payable	—	—	1,877,778	—	—	1,877,778
Notes payable	946,694,107	—	—	—	—	946,694,107
<b>Total current liabilities payable from unrestricted assets</b>	<b>4,704,193,457</b>	<b>7,144,683</b>	<b>3,451,934</b>	<b>249,290</b>	<b>(288,770,786)</b>	<b>4,426,268,578</b>
Current liabilities payable from restricted assets:						
Accrued interest payable	—	8,177	—	—	—	8,177
Accounts payable and accrued liabilities	—	322,571	—	—	—	322,571
Unearned revenue	—	3,032,327	—	—	—	3,032,327
Mortgage loan insurance and liabilities under guaranteed obligations	—	8,774,954	19,000,000	—	—	27,774,954
Bonds and mortgage-backed certificates payable	—	28,536,370	—	—	—	28,536,370
<b>Total current liabilities</b>	<b>4,704,193,457</b>	<b>47,819,082</b>	<b>22,451,934</b>	<b>249,290</b>	<b>(288,770,786)</b>	<b>4,485,942,977</b>
Non-current liabilities:						
Liability under guaranteed obligations	120,374,000	—	48,187,413	1,074,697	—	169,636,110
Accounts payable and accrued liabilities	24,769,428	—	—	—	—	24,769,428
Participation agreement payable	—	—	20,077,778	—	—	20,077,778
Notes payable	2,817,628,081	—	—	—	—	2,817,628,081
Net pension liability	144,206,599	59,160,168	—	—	—	203,366,767
Non-current liabilities payable from restricted assets:						
Bonds and mortgage-backed certificates payable	—	140,198,036	—	—	—	140,198,036
<b>Total non-current liabilities</b>	<b>3,106,978,108</b>	<b>199,358,204</b>	<b>68,265,191</b>	<b>1,074,697</b>	<b>—</b>	<b>3,375,676,200</b>
<b>Total liabilities</b>	<b>7,811,171,565</b>	<b>247,177,286</b>	<b>90,717,125</b>	<b>1,323,987</b>	<b>(288,770,786)</b>	<b>7,861,619,177</b>
Deferred inflow of resources - pension related	2,760,008	1,132,282	—	—	—	3,892,290
<b>NET POSITION (DEFICIT):</b>						
Net investment in capital assets	5,863,728	9,950,717	—	—	—	15,814,445
Restricted for:						
Affordable housing programs	—	26,060,393	—	—	—	26,060,393
Debt service	—	5,705,711	—	—	—	5,705,711
Other housing programs	—	6,162,742	—	—	—	6,162,742
Unrestricted (deficit)	(4,579,684,891)	155,157,655	(55,753,634)	378,878	288,017,898	(4,191,884,094)
<b>Total net position (deficit)</b>	<b>(4,573,821,163)</b>	<b>203,037,218</b>	<b>(55,753,634)</b>	<b>378,878</b>	<b>288,017,898</b>	<b>(4,138,140,803)</b>
<b>TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION (DEFICIT)</b>	<b>\$ 3,240,110,410</b>	<b>\$ 451,346,786</b>	<b>\$ 34,963,491</b>	<b>\$ 1,702,865</b>	<b>\$ (752,888)</b>	<b>\$ 3,727,370,664</b>

See accompanying notes to basic financial statements.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
**(A Component Unit of the Commonwealth of Puerto Rico)**  
**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN NET POSITION (DEFICIT) — PROPRIETARY FUNDS**  
**YEAR ENDED JUNE 30, 2017**

	GDB Operating Fund	Housing Finance Authority	Tourism Development Fund	Other Non-major	Eliminations	Total
<b>OPERATING REVENUES:</b>						
<b>Investment income:</b>						
Interest income on federal funds sold	\$ 1,070,137	\$ —	\$ —	\$ —	\$ —	\$ 1,070,137
Interest income on deposits placed with banks	22,828	80,992	1,335	—	—	105,155
Interest and dividend income on investments and investment contracts	465,608	5,850,469	—	160,488	—	6,476,565
Net decrease in fair value of investments	—	(2,779,205)	(314,875)	(1,797,468)	—	(4,891,548)
Total investment income	<u>1,558,573</u>	<u>3,152,256</u>	<u>(313,540)</u>	<u>(1,636,980)</u>	<u>—</u>	<u>2,760,309</u>
<b>Interest Income on loans receivable:</b>						
Public sector	237,655,242	—	—	—	—	237,655,242
Private sector	43,792	9,800,140	681,774	—	—	10,525,706
Total interest income on loans receivable	<u>237,699,034</u>	<u>9,800,140</u>	<u>681,774</u>	<u>—</u>	<u>—</u>	<u>248,180,948</u>
Total investment income and interest income on loans receivable	<u>239,257,607</u>	<u>12,952,396</u>	<u>368,234</u>	<u>(1,636,980)</u>	<u>—</u>	<u>250,941,257</u>
<b>Non-interest income:</b>						
Fiscal agency fees	91,748	—	—	—	—	91,748
Commitment, guarantee and other service fees	94,247	7,916,626	193,771	137,417	—	8,342,061
Mortgage loan insurance premiums	—	3,400,876	—	—	—	3,400,876
Servicing and contract administration fees, net	1,797,801	—	44	—	—	1,797,845
Other income	490,105	2,233,918	18,935	46,467	—	2,789,425
Total non-interest income	<u>2,473,901</u>	<u>13,551,420</u>	<u>212,750</u>	<u>183,884</u>	<u>—</u>	<u>16,421,955</u>
Total operating revenues	<u>241,731,508</u>	<u>26,503,816</u>	<u>580,984</u>	<u>(1,453,096)</u>	<u>—</u>	<u>267,363,212</u>
<b>OPERATING EXPENSES:</b>						
Provision (release) for loan losses	<u>108,156,909</u>	<u>(4,102,152)</u>	<u>(746,868)</u>	<u>—</u>	<u>—</u>	<u>103,307,889</u>
<b>Interest expense:</b>						
Deposits	50,233,347	—	—	—	(2,505,407)	47,727,940
Securities sold under agreements to repurchase	—	—	—	—	—	—
Bonds, notes and mortgage-backed certificates	185,850,119	12,340,472	826,354	—	—	199,016,945
Total interest expense	<u>236,083,466</u>	<u>12,340,472</u>	<u>826,354</u>	<u>—</u>	<u>(2,505,407)</u>	<u>246,744,885</u>
<b>Non-interest expenses:</b>						
Salaries and fringe benefits	36,664,581	13,152,342	683	—	—	49,817,606
Depreciation and amortization	570,297	427,852	—	—	—	998,149
Occupancy and equipment costs	4,075,261	2,368,313	—	—	—	6,443,574
Legal and professional fees	8,492,917	2,645,830	395,660	60,290	—	11,594,697
Office and administrative	786,795	2,240,448	—	—	—	3,027,243
Subsidy and trustee fees	—	170,191	—	—	—	170,191
Provision (release) for losses on guarantees and letters of credit	6,445,000	—	(675,371)	(918,411)	—	4,851,218
Release for losses on other assets	—	—	—	—	—	—
Provision for mortgage loan insurance	—	1,722,735	—	—	—	1,722,735
Provision for losses on other real estate owned	250,900	1,799,503	—	—	—	2,050,403
Impairment on capital assets	91,314	—	—	—	—	91,314
Net loss on sale of real estate available for sale	—	1,113,801	—	—	—	1,113,801
Custodial credit risk loss (recovery) on deposits	—	(2,808,974)	1,329,438	247,871	1,231,665	—
Other	10,431,022	1,469,748	25,947	—	—	11,926,717
Total non-interest expenses	<u>67,808,087</u>	<u>24,301,789</u>	<u>1,076,357</u>	<u>(610,250)</u>	<u>1,231,665</u>	<u>93,807,648</u>
Total operating expenses	<u>412,048,462</u>	<u>32,540,109</u>	<u>1,155,843</u>	<u>(610,250)</u>	<u>(1,273,742)</u>	<u>443,860,422</u>
<b>OPERATING INCOME (LOSS)</b>	<u>(170,316,954)</u>	<u>(6,036,293)</u>	<u>(574,859)</u>	<u>(842,846)</u>	<u>1,273,742</u>	<u>(176,497,210)</u>

(Continued)

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN NET POSITION (DEFICIT) — PROPRIETARY FUNDS**

**YEAR ENDED JUNE 30, 2017**

	<b>GDB Operating Fund</b>	<b>Housing Finance Authority</b>	<b>Tourism Development Fund</b>	<b>Other Non-major</b>	<b>Eliminations</b>	<b>Total</b>
<b>NON-OPERATING EXPENSES</b>						
Contributions to others	(4,071,097)	(336,673)	—	—	—	(4,407,770)
Net loss on sale of loans	—	(4,748,929)	—	—	—	(4,748,929)
<b>TOTAL NON-OPERATING EXPENSES</b>	<b>(4,071,097)</b>	<b>(5,085,602)</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(9,156,699)</b>
<b>OTHER FINANCING SOURCES - net transfer-in</b>	<b>—</b>	<b>1,189,643</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>1,189,643</b>
<b>CHANGES IN NET POSITION (DEFICIT)</b>	<b>(174,388,051)</b>	<b>(9,932,252)</b>	<b>(574,859)</b>	<b>(842,846)</b>	<b>1,273,742</b>	<b>(184,464,266)</b>
<b>NET POSITION (DEFICIT) — Beginning of year (as restated, see Note 5)</b>	<b>(4,399,433,112)</b>	<b>212,969,470</b>	<b>(55,178,775)</b>	<b>1,221,724</b>	<b>286,744,156</b>	<b>(3,953,676,537)</b>
<b>NET POSITION (DEFICIT) — End of year</b>	<b>\$ (4,573,821,163)</b>	<b>\$ 203,037,218</b>	<b>\$ (55,753,634)</b>	<b>\$ 378,878</b>	<b>\$ 288,017,898</b>	<b>\$ (4,138,140,803)</b>

See accompanying note to basic financial statements.



**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Proprietary Funds

Year ended June 30, 2017

	<b>GDB Operating Fund</b>	<b>Housing Finance Authority</b>	<b>Tourism Development Fund</b>	<b>Other Non-major</b>	<b>Eliminations</b>	<b>Total</b>
<b>Cash flows from operating activities:</b>						
Cash received from interest on mortgage and construction loans	\$ —	\$ 5,854,767	\$ —	\$ —	\$ —	\$ 5,854,767
Cash paid for mortgage and construction loans	—	(30,639,851)	—	—	—	(30,639,851)
Principal collected on mortgage and construction loans	—	37,316,559	—	—	—	37,316,559
Proceeds from sale of mortgage and construction loans	—	9,313,472	—	—	—	9,313,472
Guarantee fees collected	—	—	72,634	77,243	—	149,877
Cash received from other operating noninterest revenues	4,366,146	9,774,010	212,750	106,641	—	14,459,547
Mortgage loans insurance claims paid	—	(617,400)	—	—	—	(617,400)
<b>Cash received/(paid) from transit account:</b>						
Cash received from transit account	—	301,632	—	—	—	301,632
Cash payment for other operating noninterest expenses	(1,506,002)	(6,259,185)	(297,809)	(156,925)	—	(8,219,921)
Cash received from mortgage loans insurance premiums	—	2,974,175	—	—	—	2,974,175
Cash payments for salaries and fringe benefits	(40,018,897)	(13,998,947)	(683)	—	—	(54,018,527)
Cash received (paid) from other governmental funds	4,396,557	11,024,080	—	—	—	15,420,637
Net cash provided by (used in) operating activities	<u>(32,762,196)</u>	<u>25,043,312</u>	<u>(13,108)</u>	<u>26,959</u>	<u>—</u>	<u>(7,705,033)</u>
<b>Cash flows from noncapital financing activities:</b>						
Contributions to other entities	(4,351,868)	(336,673)	—	—	—	(4,688,541)
Transfers-in	—	31,525,122	—	—	—	31,525,122
Transfers-out	—	(15,659,038)	—	—	—	(15,659,038)
<b>Net increase (decrease) in:</b>						
Deposits	(135,350,310)	—	—	—	(8,344,861)	(143,695,171)
Certificates of deposit	(76,450,823)	—	—	—	15,786,266	(60,664,557)
Repayments of bonds, notes and mortgage-backed securities	—	(46,776,825)	—	—	—	(46,776,825)
Interest paid	(57,244,948)	(3,474,655)	—	—	2,747,512	(57,972,091)
Net cash used in noncapital financing activities	<u>(273,397,949)</u>	<u>(34,722,069)</u>	<u>—</u>	<u>—</u>	<u>10,188,917</u>	<u>(297,931,101)</u>
<b>Cash flows from capital and related financing activities – acquisition of capital assets</b>	<u>3,056,125</u>	<u>(595,737)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>2,460,388</u>

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

**(A Component Unit of the Commonwealth of Puerto Rico)**

**Statement of Cash Flows – Proprietary Funds**

**Year ended June 30, 2017**

	<u>GDB Operating Fund</u>	<u>Housing Finance Authority</u>	<u>Tourism Development Fund</u>	<u>Other Non-major</u>	<u>Eliminations</u>	<u>Total</u>
Cash flows from investing activities:						
Net decrease (increase) in:						
Federal funds sold and securities purchases under agreements to resell	\$ (71,508,265)	\$ —	\$ —	\$ —	\$ —	\$ (71,508,265)
Deposits placed with banks	854,575	16,231,701	—	—	(9,670,448)	7,415,828
Purchases of investments	(83,071,559)	(10,188,301)	—	—	—	(93,259,860)
Proceeds from sales and redemptions of investments	34,262,272	21,116,237	—	—	—	55,378,509
Interest and dividends received on investments	1,291,002	6,520,555	1,240	187,697	999,005	8,999,499
Interest received on other than housing program loans	245,346,951	1,768	682,614	—	—	246,031,333
Origination of other than housing program loans	—	-	—	—	—	—
Fees collected on other than housing program loans	—	1,534,998	—	—	—	1,534,998
Principal collected on other than housing program loans	142,916,062	-	474,030	—	—	143,390,092
Proceeds from sale of real estate available for sale	—	1,121,646	—	—	—	1,121,646
Custodial credit recovery (loss) on deposits	—	2,808,974	(1,329,438)	(247,871)	(1,231,665)	—
Disbursements for acquisition and improvements to real estate available for sale	—	(4,509,846)	—	—	—	(4,509,846)
Net cash provided by (used in) investing activities	<u>270,091,038</u>	<u>34,637,732</u>	<u>(171,554)</u>	<u>(60,174)</u>	<u>(9,903,108)</u>	<u>294,593,934</u>
Net change in cash and due from banks	(33,012,982)	24,363,238	(184,662)	(33,215)	285,809	(8,581,812)
Cash and due from banks – beginning of year, as restated	43,192,179	26,400,906	191,154	33,215	(1,038,342)	68,779,112
Cash and due from banks – end of year	<u>\$ 10,179,197</u>	<u>\$ 50,764,144</u>	<u>\$ 6,492</u>	<u>\$ —</u>	<u>\$ (752,533)</u>	<u>\$ 60,197,300</u>
Reconciliation to proprietary funds:						
Statement of Net Position (Deficit)						
Cash and due from banks – unrestricted	10,179,197	39,212,506	6,492	—	(752,533)	48,645,662
Cash and due from banks – restricted	—	11,551,638	—	—	—	11,551,638
Total cash and due from banks at year end	<u>\$ 10,179,197</u>	<u>\$ 50,764,144</u>	<u>\$ 6,492</u>	<u>\$ —</u>	<u>\$ (752,533)</u>	<u>\$ 60,197,300</u>

(Continued)

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
**(A Component Unit of the Commonwealth of Puerto Rico)**  
**Statement of Cash Flows – Proprietary Funds**  
**Year ended June 30, 2017**

	<b>GDB Operating Fund</b>	<b>Housing Finance Authority</b>	<b>Tourism Development Fund</b>	<b>Other Non-major</b>	<b>Eliminations</b>	<b>Total</b>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:						
Operating income (loss)	\$ (170,316,954)	\$ (6,036,293)	\$ (574,859)	\$ (842,846)	\$ 1,273,742	\$ (176,497,210)
Adjustments to reconcile operating income/(loss) to net cash provided by (used in) operating activities:						
Investment income	(1,558,573)	(5,931,461)	(1,335)	(160,488)	—	(7,651,857)
Interest income on loans	—	(1,871)	—	—	—	(1,871)
Interest income on other than housing program loans	(237,699,034)	—	(681,774)	—	—	(238,380,808)
Other income	—	(1,363,428)	—	—	—	(1,363,428)
Capitalized interest and deferred amortization on loans	—	(3,467,731)	—	—	—	(3,467,731)
Tax credit fees	—	(147,197)	—	—	—	(147,197)
Interest expense	236,083,466	12,340,473	826,354	—	(2,505,407)	246,744,886
Provision (release) for loan losses	108,156,909	(4,102,152)	(746,868)	—	—	103,307,889
Provision for losses on other assets	7,531,125	—	—	—	—	7,531,125
Provision (release) for losses on guarantees and letters of credit	6,445,000	—	(675,371)	(918,411)	—	4,851,218
Net (increase) decrease in fair value of investments	—	2,779,206	314,875	1,797,468	—	4,891,549
Provision for losses on real estate available for sale	—	1,799,503	—	—	—	1,799,503
Recovery of real estate held for sale	—	(94,685)	—	—	—	(94,685)
Provision for losses on mortgage loan insurance	—	1,722,735	—	—	—	1,722,735
Net decrease in fair value of real estate available for sale	—	1,174,268	—	—	—	1,174,268
Amortization of prepaid assets	1,826,596	—	—	—	—	1,826,596
Net gain on sale of real estate held for sale	—	1,113,801	—	—	—	1,113,801
Credit for prior year pension contribution overpayment	811,904	457,203	—	—	—	1,269,107
Depreciation and amortization	576,388	427,852	—	—	—	1,004,240
Impairment of capital assets	91,314	—	—	—	—	91,314
Custodial credit risk recovery (loss) on deposits	—	(2,808,974)	1,329,438	247,871	1,231,665	—
Changes in operating assets and liabilities:						
Decrease in mortgage and construction loans	—	15,990,180	—	—	—	15,990,180
Interest receivable on mortgage and construction loans	—	(475,771)	—	—	—	(475,771)
Decrease in unearned revenues	—	(426,701)	—	—	—	(426,701)
Decrease in other assets	1,892,245	1,134,918	—	—	—	3,027,163
Increase (decrease) in other liabilities	(1,555,527)	(2,572,818)	169,552	(96,635)	—	(4,055,428)
Increase in guarantee fees receivable	—	—	26,880	—	—	26,880
Decrease in deferred outflow-pension related	(16,717,686)	(3,380,739)	—	—	—	(20,098,425)
Increase in net pension liability	26,541,042	5,684,240	—	—	—	32,225,282
Increase in deferred inflow-pension related	733,032	204,674	—	—	—	937,706
Decrease in due from governmental funds	4,396,557	11,024,080	—	—	—	15,420,637
Net cash provided by (used in) operating activities	\$ (32,762,196)	\$ 25,043,312	\$ (13,108)	\$ 26,959	\$ —	\$ (7,705,033)

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

**(A Component Unit of the Commonwealth of Puerto Rico)**

**Statement of Cash Flows – Proprietary Funds (Continued)**

**Year ended June 30, 2017**

	<b>GDB Operating Fund</b>	<b>Housing Finance Authority</b>	<b>Tourism Development Fund</b>	<b>Other Non-major</b>	<b>Eliminations</b>	<b>Total</b>
<b>Noncash investing and noncapital financing activities:</b>						
Accretion or amortization of discount and capitalized interest on investments securities and deposits placed with banks	\$ 430,536	\$ 1,704,443	\$ —	\$ —	\$ —	\$ 2,134,979
Decrease on loans receivable from loan write-offs	\$ 102,454,657	\$ —	\$ —	\$ —	\$ —	\$ 102,454,657
Capitalized interest on loans and other	\$ 390,582	\$ 3,467,731	\$ —	\$ —	\$ —	\$ 3,858,313
Tax credit fees collected from loans	\$ —	\$ 147,997	\$ —	\$ —	\$ —	\$ 147,997
Decrease in fair value of real estate held for sale transferred to other receivables	\$ (1,511,125)	\$ —	\$ —	\$ —	\$ —	\$ (1,511,125)
<b>Accretion of discount and capitalized interest on:</b>						
Bonds and notes payable	\$ 1,385,525	\$ (8,703,469)	\$ —	\$ —	\$ —	\$ (7,317,944)
Custodial credit risk recovery (loss) on deposits	\$ —	\$ 2,808,974	\$ (1,329,438)	\$ (247,871)	\$ (1,231,665)	\$ —
<b>Noncash transfer:</b>						
Decrease in fair value of investments	\$ —	\$ (2,779,206)	\$ (314,875)	\$ (1,797,468)	\$ —	\$ (4,891,549)
Amortization of deferred loss (included in interest expense)	\$ —	\$ 224,758	\$ —	\$ —	\$ —	\$ 224,758
Interfund transfer of mortgage loans receivable to other real estate held for sale	\$ —	\$ 99,475	\$ —	\$ —	\$ —	\$ 99,475

See accompanying notes to basic financial statements.

# GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2017

## (1) Reporting Entity

The Government Development Bank for Puerto Rico (the “Bank” or “GDB”) is a component unit of the Commonwealth of Puerto Rico (the “Commonwealth”) created by Act No. 17 of September 23, 1948, as amended (the “Act 17-1948”). Up to April 6, 2016, the Bank’s principal functions were to act as fiscal agent, paying agent and financial advisor for the Commonwealth and its agencies, instrumentalities, and public corporations (collectively referred to as public entities) and municipalities; to grant interim and long-term loans to public entities and municipalities and private enterprises, which through that date, furthered the economic development of Puerto Rico; and to act as depository or trustee of funds for the Commonwealth, its public entities and municipalities. The charter of the Bank provides for its perpetual existence, and no amendment to the charter, or to any other law of Puerto Rico, shall impair any outstanding obligations or commitments of the Bank. The Bank is exempt from taxation in Puerto Rico. The Bank’s charter, as amended, allows the Bank to invest in securities issued by any corporate entity engaged in the economic development of Puerto Rico, as well as to guarantee loans and other obligations incurred by public and private entities. The continued deterioration in the Bank’s financial condition and inability to repay its obligations, prompted among several remediation efforts, the reduction of the Bank’s role to solely act as an agent in (i) collecting on its loan portfolio and (ii) disbursing funds pursuant to strict priority guidelines. As a result, the Bank’s management concluded that an orderly wind down of its operations would mitigate the impact on its stakeholders (municipalities, depositors, and other creditors, etc.). Refer to further details about the future plans for the Bank on Notes 3 and 22.

Pursuant to Act 17-1948, the Bank may transfer annually to the general fund of the Commonwealth up to 10% of its net income or \$10 million, whichever is greater. Management of the Bank has defined net income, with the approval of the Bank’s board of directors, as the increase in unrestricted net position of business-type activities for a fiscal year. The Bank did chose to not make this transfer for the year ended June 30, 2017.

The Bank has the following blended component units: Puerto Rico Housing Finance Authority (the “Housing Finance Authority”), Puerto Rico Tourism Development Fund (the “Tourism Development Fund”), Puerto Rico Development Fund (the “Development Fund”), Puerto Rico Public Finance Corporation (the “Public Finance Corporation” or “PFC”), José M. Berrocal Finance and Economics Institute (“JMB Institute”), and Puerto Rico Higher Education Assistance Corporation (the “Education Assistance Corporation”). The balances and transactions of the component units discussed above have been blended with those of the Bank in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) because, while legally separate, they were created and can be dissolved through resolution of the Bank’s board of directors. The board of directors of each of the blended component units is substantially the same as the Bank and the Bank may impose its will or obtain a financial benefit or financial burden from each of the blended components units.

The Housing Finance Authority operates under Act No. 103 of August 11, 2011, to provide public and private housing developers with interim and permanent financing through mortgage loans for the construction, improvement, operation, and maintenance of rental housing for low and moderate-income families. The Housing Finance Authority also issues bonds and notes, the proceeds of which are deposited in separate trusts and generally invested in mortgage-backed securities collateralized by mortgage loans on properties located in Puerto Rico purchased by low and moderate-income families or used to provide subsidies to such families for the acquisition of their primary residence. The Housing Finance Authority is authorized by the U.S. Department of Housing and Urban Development (HUD) to administer the U.S. Housing Act Section 8 program in Puerto Rico, to administer the HOME Investment Partnerships (HOME) Program, and to act as an approved mortgagor, both for multifamily rental units and for single-family homes. In addition, it is an authorized issuer of Government National Mortgage Association (GNMA) mortgage-backed securities and is Puerto Rico’s State Credit Agency for the Low-Income Housing Tax Credit Program under Section 42 of the U.S. Internal Revenue Code.

The Housing Finance Authority is the public housing authority in charge of implementing the Low-Income Housing Tax Credit Program in Puerto Rico. The tax credits provide a financial incentive to construct, rehabilitate, and operate rental housing for low-income tenants. A 10-year tax credit is available for each unit set-aside for low-income use as long as eligible households occupy a specific portion of units in a building or project. The rents charged on the set-aside units are restricted, and eligible households occupy them or such units becoming vacant must be held open for eligible households for at least 15 years, plus a minimum of 15 additional years that the Authority requires.

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

Non-major funds include the Development Fund, the Public Finance Corporation, JMB Institute and the Education Assistance Corporation. The Development Fund was created in 1977 to expand the sources of financing available for the economic development of the private sector in Puerto Rico and to complement the Bank's lending activities. The Development Fund may also guarantee obligations of private sector enterprises and invest in their equity securities.

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

The JMB Institute was created in 2002 to complement the Bank's mission of promoting economic development by providing specialized training on the theory and practice of public finances and economics to talented young professionals in order to attract them to join the public service.

The Education Assistance Corporation was created in 1981 to administer the Stafford Loan Program in Puerto Rico and guarantee the payment of student loans granted by financial institutions in Puerto Rico under certain terms and restrictions. The operations of this fund were transferred to a guarantee agency designated by the U.S. Department of Education in a prior fiscal year. The Education Assistance Corporation is currently inactive.

**(2) Summary of Significant Accounting Policies**

The accounting and reporting policies of the Bank conform to U.S. GAAP, as applicable to governmental entities. The Bank follows Governmental Accounting Standards Board (GASB) statements under the hierarchy established by Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, in the preparation of its basic financial statements.

The preparation of basic financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses/expenditures during the reported period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the allowance for loan losses, the liabilities under guaranteed obligations, valuation of real estate available for sale, custodial credit loss on deposits with the Bank and the Economic Development Bank for Puerto Rico (EDB), useful lives of fixed capital assets, capital assets and contingencies.

**(a) Basis of Presentation**

*Government-Wide Financial Statements*

The statement of net position (deficit) and the statement of activities report information on all activities of the Bank. The effect of interfund balances has been removed from the government-wide statement of net position (deficit), except for the residual amounts due between governmental and business-type activities.

Internal balances are not included in the total column of the government-wide statement of net position (deficit). Interfund charges for services among functions of the government-wide statement of activities have not been eliminated. The Bank's activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through intergovernmental revenues and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged for goods or services and interest earned on investment securities and loans. Following is a description of the Bank's government-wide financial statements.

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The statement of net position (deficit) presents the Bank's assets, deferred outflows of resources, liabilities, and deferred inflow of resources, with the difference between assets plus deferred outflows of resources less liabilities plus deferred inflow of resources, reported as net position (deficit). Net position (deficit) is reported in three categories:

- Net investment in capital assets is a component of the net position (deficit) which consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances of bonds, notes, mortgage and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt are included in the component of net position (deficit).
- Restricted component of the net position (deficit) consists of restricted assets reduced by liabilities related to those assets. Restricted net assets result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted component of net position (deficit) consists of net amount of the assets, deferred outflow of resources, liabilities, and deferred inflow of resources that do not meet the definition of the two preceding categories. Unrestricted component of net position (deficit) often is assigned, in order to indicate that management does not consider them to be available for general operations. Unrestricted component of net position (deficit) often has constraints on use that are imposed by management, but such constraints may be removed or modified.

When both restricted and unrestricted components of net position are available for use, it is the Bank's policy to use restricted components of net position, and then, unrestricted components of net position as they are needed and available.

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

#### *Fund Financial Statements*

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

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental and proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column. In the case of proprietary funds, each individual blended component unit of the Bank with the exception of the Development Fund, the Public Finance Corporation, the JMB Institute, and the Education Assistance Corporation, which have been grouped as other non-major funds, has been reported as a separate major fund in the fund financial statements.

Fund balances for each governmental fund are displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

- Nonspendable – amounts that are not in spendable form or are legally or contractually required to be maintained intact.



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- **Restricted** – amounts that are legally restricted by outside parties, constitutional provisions, or enabling legislation for a specific purpose.
- **Committed** – amounts that can be spent only for specific purposes determined by a formal action of the government’s highest level of decision-making authority. Commitments are made and can be rescinded only by a formal action of the government’s highest level of decision-making authority. The Bank’s highest decision-making level of authority rest with the Bank’s board of directors. The Bank did not have any committed resources as of June 30, 2017.
- **Assigned** – intent to spend resources on specific purposes expressed by the governing body.
- **Unassigned** – amounts that do not fall into any other category above. Negative unassigned amounts are reported, if any, and represent expenditures incurred for specific purposes exceeding the amounts previously restricted, committed, or assigned to those purposes.

When both restricted and unrestricted resources (the total amount of committed, assigned and unassigned fund balance) are available for use, it is the Bank’s policy to use restricted resources first, and then, unrestricted resources as they are needed and available. Further, when components of unrestricted fund balance can be used for the same purpose, committed fund balance is depleted first followed by assigned fund balance. Unassigned fund balance is applied last.

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

- **HUD Programs** – This special revenue fund accounts for the subsidy to low and moderate-income families for the rental of decent and safe dwellings under the U.S. Housing Act Section 8 programs.
- **HOME Program** – This special revenue fund is used to account for the specific revenue sources related to the HOME Program. The objectives of this special revenue fund include: (1) expanding the supply of decent and affordable housing, particularly housing for low-income families; (2) strengthening the abilities of state and local governments to design and implement strategies for achieving adequate supplies of decent, affordable housing; (3) providing financial and technical assistance to participating jurisdictions, including the development of model programs for affordable low-income housing; and (4) extending and strengthening partnership among all levels of government and private sector, including for-profit and nonprofit organizations, in the production and operation of affordable housing.
- **Affordable Housing Mortgage Subsidy Programs** – This special revenue fund is used to account for the proceeds of specific revenue sources under the different subsidy programs of the Housing Finance Authority, which are as follows:
  - **Affordable Housing Mortgage Subsidy Programs (AHMSP) Act. No. 124** – Under this program, the Housing Finance Authority commits to provide a subsidy for the down payment and/or the principal and interest payments on mortgage loans originated under a predetermined schedule of originations. Loans originated, as well as servicing, are kept by the originating financial institution. There was no open schedule of originations under this program as of June 30, 2017.
  - **My New Home Program** – This program has revenues provided by Act. No. 122 of August 6, 2010, as amended, which assigned to the Housing Finance Authority, for a period of seven years, a portion of no less than 80% of the unreserved monies and other liquid funds abandoned or unclaimed in financial institutions that will be transferred to the general fund of the Commonwealth. This program provides subsidies to eligible families in the purchase of a principal residence through reimbursement of origination and closing costs.
  - **My Own Home Program** – This program has revenues provided by Act. No. 34 of June 26, 2013. This program provides subsidies to eligible families in the purchase of a principal residence through reimbursement of origination and closing costs.

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- New Secure Housing Program – This program provided federal and local resources directed to plan, coordinate, and develop the construction of new housing units as a replacement for those destroyed by Hurricane Georges in 1998, and to attend to the housing needs of those families living in hazard-prone areas. No additional subsidies are expected to be provided under this program.

**(b) *Measurement Focus and Basis of Accounting***

The government-wide and proprietary funds financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the time the related cash flow takes place. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Bank considers revenues to be available if they are collected within 120 days after the end of the fiscal year. Principal revenue sources considered susceptible to accrual include federal and Commonwealth funds to be received by the HUD Programs and HOME Program. Other revenues are considered to be measurable and available only when cash is received. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, principal and interest on general long-term debt, claims and judgments, and compensated absences are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

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

**(c) *Securities Purchased under Agreements to Resell and Federal Funds Sold***

The Bank enters occasionally into purchases of securities under agreements to resell and federal funds sold. The amounts advanced under these agreements generally represent short-term loans and are reflected as an asset. The securities underlying these agreements are usually held by the broker or his/her agent with whom the agreement is transacted. As of June 30, 2017, there were \$158.8 million in federal funds sold and no securities purchased under agreements to resell outstanding.

**(d) *Fair Value Measurement***

The Bank categorizes its fair value measurements within the fair value hierarchy established by U.S. GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the assets or liability, either directly or indirectly; Level 3 inputs are significant unobservable inputs.

**(e) *Investments and Investment Contracts***

Investments and investment contracts are reported at fair value, except for money market instruments and participating investment contracts with a remaining maturity at the time of purchase of one year or less, and nonparticipating investment contracts (guaranteed investment contracts), which are carried at cost; and investment positions in 2a-7 like external investment pools, which are carried at the pools' share price. Investments also include preferred

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stocks/interests of various local enterprises that do not have readily determinable fair value. These investments in preferred stocks are temporary and the Bank generally does not have the ability to exercise significant influence over the investees' operating and financial policies; 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. Realized gains and losses from the sale of investments and unrealized gains and losses of outstanding investments are included in net increase (decrease) in fair value of investments in the statement of revenues, expenditures and changes in fund balances (deficit)-governmental funds and in the statement of revenues, expenditures and changes in net position (deficit)-proprietary funds.

Fair value of the Bank's investments is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations (Level 1 inputs), based upon quoted prices for similar instruments in active markets (Level 2 inputs) or based on unobservable inputs that may also be impacted by adjustments to reflect nonperformance or credit risk (Level 3 inputs).

In accordance with the specific requirements established in the bond indentures, the Bank has invested certain debt proceeds in U.S. government obligations, U.S. and Puerto Rico mortgage-backed securities, and investment contracts. These U.S. government obligations, mortgage-backed securities, and investment contracts are held in custody by the trustee of the bond issue in the name of the Bank.

**(f) *Loans Receivable, Allowance for Loan Losses and Liabilities under Guaranteed Obligation***

*General Policy* — Loans are presented at the outstanding unpaid principal balance reduced by the allowance for loan losses. The allowance for loan losses is established through a provision recorded in the statement of activities. The Bank determines the allowance for loan losses by portfolio sector, which consist of the public and private sector loans. The allowance for loan losses is based on management's evaluation of the risk characteristics of the loans including such factors as the nature of individual credits outstanding, past loss experience, known and inherent risks in the portfolios, sources of repayment, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and general economic conditions. Loan charge-offs are recorded against the allowance when management believes that the collection of the principal is unlikely. Recoveries of amounts previously charged off are credited to the respective allowance. Because of uncertainties inherent in the estimation process, management's estimate of credit losses in the outstanding loans receivable portfolios and the related allowance may change if economic and other conditions differ substantially from the assumptions used in making the estimates. Such adjustments to original estimates, as necessary, are made in the period on which these factors and other relevant considerations indicate that loss levels vary from previous estimates. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

*i. Allowance for Loan Losses— Public Sector*

The Bank's principal function was to provide financing to the Commonwealth and its public entities and municipalities. The financing activities included interim financing for capital improvements payable from the Commonwealth's general obligation bonds or revenue bonds issued by the corresponding public entity, and loans to finance the Commonwealth's budget deficit payable from the Puerto Rico Sales Tax Financing Corporation (the "Sales Tax Corporation" or "COFINA"), seasonal collection of income taxes and annual appropriations made by the Legislature Assembly of the Commonwealth of Puerto Rico (the Legislature or Legislative Assembly). The aggregate amount of allowance of losses on these loans has increased in recent years as a result of (i) the deterioration of the fiscal situation and financial condition of the Commonwealth and its public entities, (ii) the inability to complete certain financing and liability management transactions due to limited market access and (iii) general market conditions, which in turn have negatively affected the ability of the Commonwealth and its public entities to permanently finance their capital expenditures and operating deficits by issuing bonds and notes.

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The Bank considers the loans within the public-sector as impaired based on current information and events, including the significant delays in the receipt of the scheduled debt service payment mentioned above. In management's opinion, it is highly probable that the Bank will be unable to collect all amounts due according to the loan's original contractual terms. The Bank's management used applicable authoritative literature, general background information and recent relevant information included in the Commonwealth and Bank's fiscal plan to establish an allowance for loans losses. Specifically, the Bank established an allowance for losses on these impaired loans based on management's estimate of the present value of expected debt service payments discounted at the loans' effective interest rate. The Bank determined that major sources of repayment on this portfolio were property taxes, sales and use taxes, refinancing through bond issuances, appropriations from the Commonwealth, operating revenues of the borrowers, rental income generated by the borrowers, federal funding and collateral sales. To identify public sector loans that must be individually measured for impairment, the population of all loans outstanding was segregated into two general portfolios based on groups of borrowers: (1) agencies and corporations and (2) municipalities. Agencies and corporations and municipalities portfolios were additionally segregated into the following risk-based buckets taking into consideration their source of repayment, guaranty and payment history. The risk based buckets included i) loans with a reliable source of repayment, ii) loans with an unreliable source of repayment that were not performing according to contract terms (as to principal and interest) and did not have any additional source of repayment, iii) loans with unreliable source of repayment that were not performing according to contract terms, but had real estate collateral as an additional source of repayment iv) loans with an unreliable source of repayment that were only paying interest and did not have any additional source of repayment, (v) loans with an unreliable source of repayment that were performing as to principal and interest, but did not have any additional source of repayment. For loans identified as those to be individually measured for impairment, resulting present value of estimated future cash flows was compared with the respective balance of the recorded investment in the loan to determine the impairment amount or required allowance for loan losses. For private loans, the most recent expected future cash flow expectations were used to determine required allowance for loan losses.

In relation to interest income recognition, for loans to public sector entities, the Bank classified loans as nonaccrual when management determined that any of the following characteristics were present: (a) a loan was six months past due; (b) it had no current source of repayment; (c) it was not covered by a formal commitment from the Commonwealth; and (d) it did not have designated collateral or such collateral is insufficient. Based on these four elements, the loan was placed in nonaccrual status and all accrued interest receivable is reversed from interest income. Interest income on non-accrual loans is thereafter recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when there is adequate evidence to believe that the loans will be performing as contracted.

*ii. Allowance for Loan Losses – Private Sector*

Another function of the Bank was to provide financing to private entities that operate within specific industries of interest to the Commonwealth, due to the economic impact of their operations to the Puerto Rico economy. All of these transactions are approved by the Board of Directors of the Bank and as of June 30, 2017, are mainly related to the dairy industry, tourism industry, and affordable housing programs in Puerto Rico. The Housing Finance Authority grants mortgage loans to low and moderate-income families for the acquisition of single-family housing units and to developers of low and moderate-income multifamily housing units in Puerto Rico. Historical loss factors are separately calculated for each segment and applied to the outstanding loan balance of the portfolio. The Housing Finance Authority has a policy of charging off real estate single-family unit mortgage loans that are over 60 months past due.

Loans considered to be impaired are generally reduced to the present value of expected future cash flows, discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral, if the loan is collateral dependent, by establishing an allowance for loan losses.

As a general procedure, the Bank internally reviews appraisals as part of the underwriting and approval process and also for credits considered impaired. Appraisals may be adjusted by management due to their age, property conditions, geographical area or general market conditions as deemed necessary. The adjustments applied are based upon internal

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information, such as other appraisals and/or loss severity information available in several real estate market publications.

In relation to interest income recognition, for loans to private sector entities, the Bank classified loans as nonaccrual when management determined that any of the following characteristics were present: (a) a loan was six months past due; (b) it had no current source of repayment; (c) it was not covered by a formal commitment from the Commonwealth; and (d) it did not have designated collateral or such collateral is insufficient. Based on these four elements, a loan is placed in nonaccrual status and all accrued interest receivable is reversed from interest income. Interest income on nonaccrual loans is thereafter recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when there is adequate evidence to believe that the loans will be performing as contracted.

**(g) *Liabilities under Guaranteed Obligations and Letters of Credit***

Management of the Bank periodically evaluates the credit risk inherent in the guarantees and letters of credit portfolio on the same basis as loans are evaluated. The Bank charges, as expense, the amount required to cover estimated losses by estimating a liability under guaranteed obligations and letters of credit relating to guaranteed debt in default, determined on the basis of the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guaranty. Such outflow estimates incorporate considerations about the fair value of the debt's collateral, timing frame of payments and a general component for the risk inherent in the guarantees and letters of credit outstanding, established as a percentage of the principal amount of the underlying debt, based on the Bank's loss experience on financial guarantees and letters of credit, and management's best judgment.

When a guarantee or letter of credit is honored, the Bank recognizes any disbursement as a non-performing loan; therefore, no interest is accrued on the principal. Such disbursement reduces the liability under guaranteed obligation that had been previously recognized, while creating at the same time a related allowance for loan losses for the same amount on such non-performing loan recognized. Any deficiency in the liability under guaranteed obligation for remaining outstanding guarantees is recorded as an additional expense.

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

Pursuant to the legislation under which the Tourism Development Fund was created, the Executive Director of the Tourism Development Fund is required to certify each year to the Office of Management and Budget the amount, if any, that is necessary to reimburse the Tourism Development Fund for disbursements made, as defined, in the previous year in excess of revenues collected (net disbursement). On December 16, 2009, Act No. 173 was enacted, which amended the legislation that created the Tourism Development Fund, to modify the definition of net disbursement to include disbursements made by the Tourism Development Fund for (i) loans to third parties, (ii) the acquisition of loan participations, and (iii) the acceleration of maturities of loans, notes, bonds or other type of debt guaranteed by the Tourism Development Fund. However, Act No. 173 provides that such disbursements shall not be deemed made in the year in which the disbursement occurs but shall be deemed made in the year in which the Executive Director of the Tourism Development Fund determines that a loss was incurred with respect to a loan, note, bond or debt (such determination being referred to as a realized loss). The Director of the Office of Management and Budget may include the amount subject to reimbursement in the Commonwealth's general fund budget for the following fiscal year for the Legislature's consideration and approval. The Legislature is not obligated to authorize such appropriations. As of June 30, 2017, there were no outstanding claims for reimbursements requested by the Executive Director of the Tourism Development Fund to the Director of the Office of Management and Budget.

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(h) ***Debt Issue Costs***

Bond issue costs are recognized as an expense in the period incurred.

(i) ***Real Estate Available for Sale***

Real estate available for sale comprises properties acquired in lieu of payment. It also includes loans that are treated as if the underlying collateral had been foreclosed because the Bank has taken possession of the collateral, even though legal foreclosure or repossession proceedings have not taken place. Those properties are carried at the lower of cost or fair value, which is established by the Bank by using a third-party professional assessment or based upon an appraisal, less estimated costs to sell. At the time of acquisition of properties in full or in partial satisfaction of loans, any excess of the loan balance over the fair value of the properties less estimated costs to sell is charged against the allowance for loan losses. Subsequent declines in the value of real estate available for sale are charged to expense. Gain or loss on sale of real estate available for sale is included within revenues or expenses, respectively, in the accompanying statement of activities and within non-interest income or non-interest expense in the accompanying statement of revenues, expenditures, and changes in net position (deficit).

(j) ***Capital Assets***

Capital assets, which include premises and equipment, are stated at cost less accumulated depreciation and amortization. Capital assets are defined by the Bank as assets that have a cost of \$500 or more at the date of acquisition and have an expected useful life of three or more years. Depreciation is charged to operations and included within expenses and is computed on the straight-line basis over the estimated useful lives of the depreciable assets. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Costs of maintenance and repairs which do not improve or extend the lives of the respective assets are charged to expense as incurred. Estimated useful lives are as follows:

<b>Capital asset</b>	<b>Years</b>
Building	40 years
Leasehold improvements	Lesser of 10 years or lease term
Information systems	3–5 years
Office furniture and equipment	5 years
Vehicles	5 years

The Bank reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable and in accordance with GASB 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. The amount of the impairment of these assets is determined by comparing the carrying value with the fair value of the asset. Fair value is determined based on discounted cash flows or appraised values, depending on the nature of the assets.

(k) ***Securities Sold under Agreements to Repurchase***

The Bank enters into sales of securities under agreements to repurchase. These agreements generally represent short-term borrowings and are reflected as a liability. The securities underlying these agreements are usually held by the broker or his/her agent with whom the agreement is transacted. All sales of investments under agreements to repurchase are based on fixed terms. In investing the proceeds of securities sold under agreements to repurchase, the Bank's policy is for the term to maturity of investments to be on or before the maturity of the related repurchase

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agreements. As of and during the year ended June 30, 2017, there were no securities sold under agreement to repurchase.

(l) ***Compensated Absences***

The liability for compensated absences reported in the government wide and proprietary funds financial statements consists of unpaid, accumulated vacation and sick leave balances. In the governmental funds, a liability for compensated absences is recorded only to the extent the obligation has matured. The liability has been calculated using the vesting method, in which leave amounts for both, employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination, are included. The liability has been calculated based on the employee's current salary level and includes salary related costs.

The employees of the Bank are granted 30 days of vacation and 18 days of sick leave annually. Vacation and sick leave may be accumulated up to a maximum of 60 and 90 days, respectively. In the event of employee resignation, an employee is reimbursed for accumulated vacation and sick leave days up to the maximum allowed. The government wide and proprietary funds basic financial statements present the cost of accumulated vacation and sick leave within accounts payable and accrued liabilities.

(m) ***Liability for Losses on Mortgage Loans Insurance***

The estimated liability for losses on mortgage loans insurance is determined on the basis of the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the loan insurance guaranty. Such outflows estimate incorporates considerations based on management's evaluation of potential losses on insurance claims after considering economic conditions, market value of related property, and other pertinent factors. Such amount is, in the opinion of management, adequate to cover estimated future probable mortgage loans insurance losses. Actual losses for mortgage loans insurance are charged, and recoveries, if any, are credited to the estimated liability for losses on mortgage loans insurance. Because of uncertainties inherent in the estimation process, management's estimate of losses in the outstanding loans guarantee portfolio and the related liability may change in the near future.

(n) ***Deferred Outflow/Inflow of Resources***

In addition to assets, the statement of net position (deficit) and/or balance sheet will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. On the business-type activities of the government-wide financial statements and proprietary funds' statement of net position (deficit) there are two major captions that qualify for reporting in this category: (i) the unamortized balance of losses on bond refunding and (ii) pension related items. A loss on refunding of debt results from the difference between the reacquisition price and the net carrying amount of the old debt. This amount is capitalized and amortized over the shorter of the life of the refunded or refunding debt and the amortization recognized as a component of interest expense in a systematic and rational manner. Of the pension related items (further disclosed in Notes 5 and 16), changes in proportionate share of contributions and differences between expected and actual experience, are capitalized and recognized over a period equal to the expected remaining working lifetime of active and inactive participants. Net differences between projected and actual earnings on pension plan investments is deferred and recognized over a five-year period. Pension contributions made subsequent to the measurement date will be recognized as a reduction of the net pension liability after the next measurement date. There were no deferred outflows of resources at the governmental funds level.



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In addition to liabilities, the statement of net position (deficit) and/or balance sheet will sometimes report a separate section for deferred inflows of resources are presented. This separate financial statement element represents an acquisition of net position and resources that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. On the business-type activities of the government-wide financial statements and proprietary funds' statement of net position (deficit) there is one major caption that qualifies for reporting in this category, which consists of pension related items. With respect to the pension related items (further disclosed in Notes 5 and 16), changes in proportionate share of contributions and differences between expected and actual experience, are capitalized and recognized over a period equal to the expected remaining working lifetime of active and inactive participants. Net differences between projected and actual earnings on pension plan investments is deferred and recognized over a five-year period. A deferred inflow of resources has also been recorded in the governmental funds representing intergovernmental grant revenue that does not meet the "available" criteria for revenue recognition in the current period under the modified accrual basis of accounting. In subsequent periods, when the applicable resources become available, the deferred inflow of resources is removed from the balance sheet and the revenue is recognized.

(o) ***Conduit Debt***

The Housing Finance Authority has issued notes and bonds in connection with the financing of low and moderate-income housing projects. Certain of the obligations issued by the Housing Finance Authority are considered conduit debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements. The Bank, the Housing Finance Authority and the Commonwealth, except for the assets held in trust and earnings thereon, are not liable directly or indirectly for the payment of such obligations.

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

From time to time, the Public Finance Corporation issues bonds, the proceeds of which are used to purchase from the GDB Operating Fund promissory notes of the Commonwealth, and of certain of its public entities, or to refund such previously issued bonds. The bonds are limited obligations of the Public Finance Corporation and, except to the extent payable from bond proceeds and investments thereon, are payable solely from the pledge and assignment of amounts due on the notes. Principal and interest on the notes are payable solely from legislative appropriations to be made pursuant to acts approved by the Legislature. The underlying notes represent debt of the issuing instrumentalities. The bonds are considered conduit debt, and therefore neither the bonds nor the notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements. There was no issuance of these bonds during fiscal year 2017.

(p) ***Loan Origination Costs and Commitment Fees***

The Bank recognizes loan origination and commitment fees as income in the period received and the direct loan origination costs as an expense in the period incurred.

(q) ***Guarantee Fees***

Guarantee fees are amortized over the life of the related guarantee using the straight-line method.

(r) ***Transfers of Receivables***

Transfers of receivables are accounted and reported as a sale if the Bank's continuing involvement with those receivables is effectively terminated. This approach distinguishes transfers of receivables that are sales from transfers that are collateralized borrowings.

The Bank's continuing involvement is considered to be effectively terminated if all of the following criteria are met: (i) the transferee's ability to subsequently sell or pledge the receivables is not significantly limited by constraints imposed by the Bank, either in the transfer agreement or through other means, (ii) the Bank does not have the option

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or ability to unilaterally substitute for or reacquire specific accounts from among the receivables transferred, except in certain limited circumstances, (iii) the sale agreement is not cancelable by either party, including cancellation through payment of a lump sum or transfer of other assets or rights, and (iv) the receivables and the cash resulting from their collection have been isolated from the Bank.

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

(s) ***Mortgage Loans Insurance Premiums***

Premiums on insured mortgage loans are recognized as earned during the period of the insurance coverage.

(t) ***Accounting for Pension Cost***

Prior to the enactment of Act No. 106-2017 on August 23, 2017, the Bank accounted for pension costs under the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, which were adopted by the Bank effective July 1, 2016. For further information on act No. 106-2017 and implementation of the new PayGo system, refer to Notes 16 and 22. GASB Statement No. 68 required that employers and nonemployer contributing entities report a net pension liability (NPL) and related pension accounts, such as pension expense and deferred outflows/inflows of resources, as determined by the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS) under the requirements contained in GASB Statement No. 67, *Financial Reporting for Pension Plans-an amendment of GASB Statement No. 25*. Previously, GASB Statement No. 27 required employers to report a net pension obligation as determined under the requirements of GASB Statement No. 25, *Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans*. The Commonwealth, through ERS, has implemented GASB Statement No. 67 since fiscal year 2014. GASB Statement No. 67 replaced the requirements of GASB Statement No. 25 and specified the required approach to measuring the pension liability of employers and nonemployer contributing entities for benefits provided through the pension plan. GASB Statement No. 67 required plans (like ERS) to calculate an NPL to be measured as the total pension liability less the amount of the pension plan's fiduciary net position. GASB Statement No. 71 requires that upon implementation of GASB Statement No. 68, a government recognize a beginning deferred outflow of resources for its pension contributions made subsequent to the measurement date of the beginning net pension liability upon adoption. The major fundamental change brought by GASB Statement No. 67, was switching from the then existing "funding-based" accounting model, where the Annual Required Contribution (ARC) was compared to the actual payments made and that difference determined the net pension obligation; to an "accrual basis" model, where the total pension obligation (actuarially determined) is compared to the plan net position and the difference represents the NPL. In essence, GASB Statement No. 68 brings the effect of GASB Statement No. 67 into the accounting records of the Bank, whose employees participate in ERS. Further details on the accounting for pension costs and the impact of its adoption are disclosed in Notes 5 and 16.

Prior to August 23, 2017, the Bank was considered a "cost-sharing" employer of ERS. Therefore, for the fiscal year ended June 30, 2017, the Bank reported its allocated share of ERS's NPL and the related pension accounts taking into consideration the following:

- The individual proportion to the collective NPL of all the governments participating.
- Each participating government-employer's proportionate share is consistent with the manner in which contributions are determined and should reflect that participating government-employer's projected long-term contribution effort relative to that of all the participating government employers. Contributions that separately finance specific liabilities of an individual participating government-employer to ERS (such a local

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participating government-employer early retirement incentives) are not included in determining the proportionate share of the overall projected long-term contribution effort.

- The contributions that reflect each participating government-employer's projected long-term contribution effort are the Act No. 116 of 2011 statutory payroll-based contribution, the Act No. 3 of 2013 supplemental contribution, other special contributions, and the Act No. 32 of 2013 Additional Uniform Contribution (AUC). Other contributions that do not reflect a participating government-employer's projected long-term contribution effort are excluded from the proportionate share calculation.
- The AUC, required a contribution that it is determined in the aggregate and ERS then allocated the total amount to each participating government-employer based on such participating government-employer's payroll. However, due to a history of non-payment of the AUC by many participating government-employers and the expected continuing nonpayment of such contributions during fiscal year 2017, it was determined that the collected AUC amounts would be excluded from the proportionate share determination, in order to prevent an overallocation of NPL amounts to those participating government-employers who have paid their AUC (or are expected to do so) and an under allocation of NPL amounts to the participating government-employers who have not paid their AUC (or are not expected to do so).

ERS elected to use as measurement date the July 1 financial information. Based on this the June 30, 2015 actuarial data was used upon implementation as of July 1, 2016. Under GASB Statement No. 71, the Bank recognized upon implementation of Statement No. 68, a beginning deferred outflow of resources for its pension contributions made subsequent to the measurement date.

For the purpose of applying the requirements of GASB Statements No. 68 and No. 71, the Bank's annual pension expense for the year ended June 30, 2017 amounted to approximately \$20.8 million and the NPL as of June 30, 2017 amounted to approximately \$203.4 million. Disclosures required under GASB Statement No. 68 can be found in Note 16.

Neither GASB Statements No. 68 nor No. 71 affect the way the Bank may choose to fund its pension obligations. While GASB Statement No. 68 changes the amount of the pension liability that is reported on the financial statements, governments may continue to fund their plans by calculating an actuarially determined contribution and measuring their funded status as it relates to that actuarially determined contribution. GASB Statement No. 68 requires certain disclosures if an actuarially determined contribution has been calculated.

**(u) Future Adoption of Accounting Pronouncements**

The following new accounting standards have been issued by the GASB but are not yet effective at June 30, 2017:

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. This statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans. The scope of this statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. In addition, this statement details the recognition and disclosure requirements for employers with payables to defined-benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This statement also addresses certain circumstances

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in which a nonemployer entity provides financial support for OPEB of employees of another entity. The provisions of this statement are effective for fiscal years beginning after June 15, 2017.

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. This statement improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts, or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements, in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate. This statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This statement requires that a government recognize revenue when the resources become applicable to the reporting period. This statement is not effective until fiscal year 2018.
- GASB Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement. This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

This Statement requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

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- GASB Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less. This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria. This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.
  
- GASB Statement No. 85, *Omnibus 2017*. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Specifically, this Statement addresses the following topics:
  - Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation.
  - Reporting amounts previously reported as goodwill and “negative” goodwill.
  - Classifying real estate held by insurance entities.
  - Measuring certain money market investments and participating interest earning investment contracts at amortized cost.
  - Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus.
  - Recognizing on-behalf payments for pensions or OPEB in employer financial statements.
  - Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB.
  - Classifying employer-paid member contributions for OPEB.
  - Simplifying certain aspects of the alternative measurement method for OPEB.
  - Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

- GASB Statement No. 86, *Certain Debt Extinguishment Issues*. This Statement improves the consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to

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financial statements for debt that is defeased in substance. The requirements of this Statement are effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

- GASB Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.
- GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5-22 of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged. The requirements of this Statement should be applied prospectively.
- GASB Statement No. 90, *Majority Equity Interests, an amendment of GASB Statements No. 14 and No. 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a

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majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. For all other holdings of a majority equity interest in a legally separate organization, a government should report the legally separate organization as a component unit, and the government or fund that holds the equity interest should report an asset related to the majority equity interest using the equity method. This Statement establishes that ownership of a majority equity interest in a legally separate organization results in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit. This Statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged. The requirements should be applied retroactively, except for the provisions related to (1) reporting a majority equity interest in a component unit and (2) reporting a component unit if the government acquires a 100 percent equity interest. Those provisions should be applied on a prospective basis.

- GASB Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

- GASB Statement No. 93, *Replacement of Interbank Offered Rates (IBOR)*. The objective of this Statement is to address accounting and financial reporting implications that result from the replacement of an IBOR most notably the London Interbank Offered Rate (LIBOR).

As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form at the end of 2021, prompting governments to amend or replace financial instruments for the purpose of replacing LIBOR with other reference rates, by either changing the reference rate or adding or changing fallback provisions related to the reference rate. The removal of LIBOR as an appropriate benchmark interest rate is effective for reporting periods ending after December 31, 2021. All other requirements of this Statement are effective for reporting periods beginning after June 15, 2020. Earlier application is encouraged.

- GASB Statement No. 94, *Public-Private and Public-Public Partnership and Availability Payment Arrangement*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). A PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity)

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to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements (APAs). An APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction. The requirements of this Statement are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. Earlier application is encouraged.

- GASB Statement No. 95, *Postponement of the effective dates of Certain Authoritative Guidance*. The primary objective of this Statement is to provide temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. That objective is accomplished by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later.

The effective dates of certain provisions contained in the following pronouncements are postponed by one year:

- Statement No. 83, *Certain Asset Retirement Obligations*
- Statement No. 84, *Fiduciary Activities*
- Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*
- Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*
- Statement No. 90, *Majority Equity Interests*
- Statement No. 91, *Conduit Debt Obligations*
- Statement No. 92, *Omnibus 2020*
- Statement No. 93, *Replacement of Interbank Offered Rates*
- Implementation Guide No. 2017-3, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan Reporting)*
- Implementation Guide No. 2018-1, *Implementation Guidance Update—2018*
- Implementation Guide No. 2019-1, *Implementation Guidance Update—2019*
- Implementation Guide No. 2019-2, *Fiduciary Activities*.

The effective dates of the following pronouncements are postponed by 18 months:

- Statement No. 87, *Leases*
- Implementation Guide No. 2019-3, *Leases*.

Earlier application of the provisions addressed in this Statement is encouraged and is permitted to the extent specified in each pronouncement as originally issued. The requirements of this Statement are effective immediately.

Management is evaluating the impact that these Statements will have on the Banks's basic financial statements.



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### (3) Going Concern Uncertainty

The Bank traditionally served as interim lender to the Commonwealth and its public corporations (also referred to herein as instrumentalities) and municipalities in anticipation of the issuance of long-term bonds and notes by such entities in the municipal bond market. The Bank has also provided financing to the Commonwealth and its instrumentalities to finance their respective budget deficits, collateral requirements under swap agreements and to meet mandatory payments of obligations. As a result, the Bank's liquidity and financial condition depends to a large extent on the repayment of loans made to the Commonwealth and its instrumentalities. The Commonwealth and its instrumentalities are in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. Conditions that adversely affect the ability of the Commonwealth and its instrumentalities to raise cash (including limited access to capital markets) and repay their interim and other loans to the Bank have an adverse effect on the Bank's liquidity and financial condition.

Upon the establishment of the Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA), GDB's role was reduced to act as an agent in (i) collecting on its loans portfolio and (ii) disbursing funds pursuant to strict priority guidelines. Therefore, taking into consideration the scenario described above, given the reduced services that the Bank was then providing and given that no appropriations were assigned to the Bank for fiscal years 2018 and 2019, on March 23, 2018 the Bank ceased its operations and management initiated an orderly wind down process consisting of a restructuring support agreement entered into by FAFAA and the Bank with a significant portion of the Bank's major stakeholders, subject to different milestones. Details about the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) are further discussed in Note 4 and details of the restructuring support agreement and its execution pursuant a Qualifying Modification under Title VI of PROMESA (the Qualifying Modification) is further discussed in Notes 4 and 22.

As a result, Management believes that there is substantial doubt about the Bank's ability to continue as a going concern.

### (4) Enactment of PROMESA

On June 30, 2016, then President Barack Obama signed PROMESA into law (as codified under 48 U.S.C. §§ 2101-2241). In general terms, PROMESA seeks to provide the Commonwealth with fiscal and economic discipline through, among other things: (i) the establishment of the Oversight Board, whose responsibilities include the certification of fiscal plans and budgets for the Commonwealth and its related entities; (ii) a temporary stay of all creditor lawsuits; and (iii) two alternative methods to adjust unsustainable debt: (a) a voluntary debt modification process under Title VI of PROMESA, which establishes a largely out-of-court debt restructuring process through which modifications to financial debt can be accepted by a supermajority of creditors; and (b) a quasi-bankruptcy proceeding under Title III of PROMESA, which establishes an in-court debt restructuring process substantially based upon incorporated provisions of the U.S. Bankruptcy Code (11 U.S.C. §§ 101, *et seq.*). Each of these elements are divided among PROMESA's seven titles, the most relevant of which for the Bank, Title VI, is discussed below.

#### *Title VI — Consensual, Out-of-Court Restructuring Process*

Title VI of PROMESA establishes an out-of-court process for restructuring Puerto Rico's debts. Under PROMESA section 601(d), the Oversight Board is authorized to establish "pools" of bonds issued by each Puerto Rico government-related issuer based upon relative priorities and other factors, as set forth in PROMESA. After establishing the pools, the government issuer or any bondholder or bondholder group may propose a modification to one or more series of the government issuer's bonds. If a voluntary agreement exists, the Oversight Board may issue a certification that: (i) the voluntary agreement conforms to the certified fiscal plan; (ii) if no fiscal plan has been certified, the voluntary agreement provides for a sustainable level of debt; or (iii) the voluntary agreement is limited to an extension of principal and interest payments on affected bonds for a period of one year. If a voluntary agreement exists, then the Oversight Board may certify the agreement as a "Qualifying Modification" by finding that either: (i) the issuer consulted with the holders of bonds in each pool prior to solicitation, all holders in each pool will be offered the same amount of consideration under the agreement, and the agreement is in the "best interest of the creditors and is feasible"; or (ii) the voluntary agreement has

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been entered into by a majority of the bondholders, all holders in each pool will be offered the same amount of consideration under the agreement, and the voluntary agreement is consistent with any restructuring support agreement executed prior to the establishment of the Oversight Board. If the voluntary agreement is certified as a "Qualifying Modification," then the issuer must provide to the Calculation Agent, Information Agent, and Oversight Board additional information as required under PROMESA section 601(f).

Once the Oversight Board approves the voluntary agreement as a Qualifying Modification and the required information has been delivered, then the issuer, through the Information Agent, may solicit votes for bondholder approval of the Qualifying Modification. The Qualifying Modification will be deemed approved by bondholders if (i) of those who actual vote, at least two-thirds of the amount outstanding in each pool vote in favor of the Qualifying Modification, and (ii) at least a majority of the aggregate principal amount of all bonds actually vote. After such voting, in order for the Qualifying Modification to be conclusive and binding on all present and future bondholders:

- Each of the issuer's bond pools must accept the Qualifying Modification based on the voting requirements above;
- The Oversight Board certifies that the voting requirements are satisfied, the Qualifying Modification complies with PROMESA § 104(i), and any conditions to effectiveness of the Qualifying Modification have been satisfied (or waived); and
- Rejecting, non-consenting secured lenders must retain their lien or receive value equal to the lesser of the amount of their claim or the value of the collateral securing such claim.

The United States District Court for the District of Puerto Rico entered an order approving the Qualifying Modification and vesting in the issuer all property free and clear of claims in respect of any bonds. The Title VI process is being implemented effective November 29, 2018 to restructure the debts of the Bank. The Bank's Title VI process is discussed in Notes 3 and 22.

**(5) Correction of Errors**

During 2017, the Bank identified various errors related to prior year financial statements, including the application of the guidance in GASB Statements No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No.27* and No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement*, which resulted in restatements and immaterial corrections of the beginning net position (deficit) of the Bank's government-wide and fund financial statements.

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The impact of the related adjustments to beginning net position/fund balance are as follows:

**Government-wide Financial Statements**

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>
Net position (deficit) – July 1, 2016, as previously reported	\$ (52,749)	(3,680,962)
Application of GASB Statements No. 68 and No. 71(c):		
Net pension liability	—	(170,329)
Deferred outflows of resources at measurement date	—	23,701
Deferred inflows of resources at measurement date	—	(2,955)
Recognition of deferred outflow of resources for pension contributions made after the measurement date (July 1, 2015)	—	7,605
Credit for prior year pension contribution overpayment	—	1,269
Custodial credit risk loss on deposits with EDB (a) and (d)	(478)	(64,765)
Custodial credit risk loss on deposits and investments with GDB (b)	(17,980)	—
Correction of immaterial errors (f) and (g)	—	(67,241)
Net position (deficit) – July 1, 2016, as restated	<u>\$ (71,207)</u>	<u>(3,953,677)</u>

**Governmental Funds**

	<u>Affordable Housing Mortgage Subsidy Program</u>
Net deficit – July 1, 2016, as previously reported	\$ (49,346)
Correction of error-custodial credit risk loss on deposits with EDB (a)	(478)
Correction of error-custodial credit risk loss on deposits and investments with GDB (b)	<u>(17,980)</u>
Net deficit – July 1, 2016, as restated	<u>\$ (67,804)</u>

**Proprietary Funds**

	<u>GDB Operating Fund</u>	<u>Housing Finance Authority</u>	<u>Other Non-major Fund</u>
Net position (deficit) – July 1, 2016, as previously reported	\$ (4,236,665)	324,410	3,574
Application of GASB Statements No. 68 and No. 71: (c)			
Net pension liability	(116,853)	(53,476)	—
Deferred outflows of resources at measurement date	16,327	7,374	—
Deferred inflows of resources at measurement date	(2,027)	(928)	—
Recognition of deferred outflow of resources for pension contributions made after the measurement date (July 1, 2015)	6,255	1,350	—
Credit for prior year pension contribution overpayment	812	457	—
Custodial credit risk loss on deposits with EDB (d)	—	(64,765)	—
Custodial credit risk loss on deposits with GDB (e)	—	(1,452)	—
Correction of immaterial errors (f), (g) and (h)	<u>(67,282)</u>	<u>—</u>	<u>(2,352)</u>
Net position (deficit) – July 1, 2016, as restated	<u>\$ (4,399,433)</u>	<u>212,970</u>	<u>1,222</u>

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*Correction of Material Errors – Governmental Activities and Governmental Funds*

- (a) An overstatement of cash and cash equivalents for approximately \$478 thousands corrected in the Affordable Housing Mortgage Subsidy Program for a custodial credit loss on deposits held at Economic Development Bank for Puerto Rico (EDB).
- (b) An overstatement of cash and cash equivalents and investments for approximately \$18 million in the Affordable Housing Mortgage Subsidy Program Fund for a custodial credit loss on deposits and investments held at GDB.

*Correction of Material Errors – Business-Type Activities and Housing Finance Authority Fund*

The correction of material errors to beginning net position of the Business-Type Activities and the Housing Finance Authority Fund includes a combination of the following:

- (c) The impact of recording pension liabilities and related amounts in accordance with GASB Statements No. 68 and No. 71. The error correction consisted of recognizing the Bank's net pension liability, deferred outflows of resources and deferred inflows of resources as of the beginning of the year and adjusting a previous year's contribution overpayment accordingly.
- (d) An overstatement of cash and cash equivalents for approximately \$65 million corrected in the Housing Finance Authority Fund for a custodial credit loss on deposits held at Economic Development Bank for Puerto Rico (EDB).
- (e) An overstatement of cash and cash equivalents and deposits for approximately \$1.5 million in the Housing Finance Authority Fund for a custodial credit loss on deposits and investments held at GDB.

*Correction of Immaterial Errors – Business-Type Activities and Non-major funds*

- (f) An overstatement on accrued interest receivable for approximately \$67 million in the GDB Operating Fund related to uncollectable interest from public sector loans.
- (g) An overstatement of accounts payable of \$41 thousand in the Non-major funds related to guarantee fee payments not recorded.
- (h) An overstatement of cash and cash equivalents and deposits in for approximately \$2.3 million in the Non-major funds for a custodial credit loss on deposits held at GDB.

**(6) Cash and Due from Banks, Federal Funds Sold, and Deposits Placed with Banks**

Custodial credit risk is the risk that, in the event of a financial institution failure, the Bank's deposits may not be returned to it. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of Treasury. The Bank does not have a formal policy for custodial credit risk for cash accounts opened with commercial banks outside Puerto Rico.

The Bank's policies for deposits placed with banks and federal funds sold establish maximum exposure limits for each institution based on the institution's capital, financial condition and credit rating assigned by nationally recognized rating agencies, except for the Bank's component units' deposits in the GDB Operating Fund. Deposits placed with banks of approximately \$13.6 million mature in fiscal year 2018. Federal funds sold mature overnight and no collateral is required.

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The table presented below discloses the level of custodial credit risk assumed by the Bank at June 30, 2017. As of June 30, 2017, \$266,402,755 of the depository bank balance of \$353,200,916 was uninsured and uncollateralized as follows:

	<b>Carrying amount</b>	<b>Depository bank balance</b>	<b>Amount uninsured and uncollateralized</b>
Cash and due from banks	\$ 78,602,116	\$ 77,479,581	\$ 2,069,950
Federal funds sold	158,764,462	158,764,462	158,764,462
Deposits placed with banks	13,587,256	116,956,873	105,568,343
<b>Total</b>	<b>\$ 250,953,834</b>	<b>\$ 353,200,916</b>	<b>\$ 266,402,755</b>

*Custodial Credit Loss on Deposits at GDB by Blended Component Units*

As further discussed in Notes 3 and 22, the Bank's management believes substantial doubt exists in the Bank's ability to continue as a going concern.

Therefore, as the Bank serves as the depository of its blended component units (Housing Finance Authority, Tourism Development Fund and Other Non-Major funds) such funds have been subject to strict restrictions and limitations since fiscal year 2016.

Based on the evaluation of the availability and recoverability of such deposits (which are now claims against the Public Entity Trust (PET) pursuant to the Bank's Qualifying Modification, as further discussed in Note 22), a custodial credit loss has been recognized on the Housing Finance Authority, Tourism Development Fund and the Other Non-major Funds as follows:

<b>Housing Finance Authority's Deposits Held with the GDB</b>			
<b>Operating Fund at June 30, 2017</b>			
<b>Type of Deposit</b>	<b>Deposit Balance</b>	<b>Custodial Credit Loss</b>	<b>Book Balance</b>
Cash	\$ 10,682,887	\$ (9,936,845)	\$ 746,042
Time deposit	98,887,099	(98,887,099)	-
<b>Total</b>	<b>\$ 109,569,986</b>	<b>\$ (108,823,944)</b>	<b>\$ 746,042</b>

<b>Tourism Development Fund's Deposits Held with the GDB</b>			
<b>Operating Fund at June 30, 2017</b>			
<b>Type of Deposit</b>	<b>Deposit Balance</b>	<b>Custodial Credit Loss</b>	<b>Book Balance</b>
Cash	\$ 1,609,503	\$ (1,603,011)	\$ 6,492
Time deposit	156,951,720	(156,951,720)	-
<b>Total</b>	<b>\$ 158,561,223</b>	<b>\$ (158,554,731)</b>	<b>\$ 6,492</b>

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Type of Deposit	Other Non-major Fund's Deposits Held with the GDB Operating Fund at June 30, 2017		
	Deposit Balance	Custodial Credit Loss	Book Balance
Cash	\$ 8,295,221	\$ (8,295,221)	\$ -
Time deposit	5,009,257	(5,009,257)	-
<b>Total</b>	<b>\$ 13,304,478</b>	<b>\$ (13,304,478)</b>	<b>\$ -</b>

The Housing Finance Authority, a blended component unit of the Bank, was audited by another auditor who issued its opinion on the 2017 stand-alone financial statements with a custodial credit loss recognition on its cash and deposits with the Bank of \$107.4 million in its proprietary fund and \$1.4 million in its governmental funds at June 30, 2017. The custodial credit loss recognized at June 30, 2017 in the proprietary fund reflects a recovery of previously recognized losses in the amount of approximately \$2.8 million and a restatement of \$1.5 million for custodial credit losses not recognized in fiscal year 2016; while the custodial credit loss recognized at June 30, 2017 in the governmental funds were all attributed to custodial credit losses not recognized in fiscal year 2016, thus restated during fiscal year 2017.

The Tourism Development Fund has recognized custodial credit losses on its cash and deposits with the Bank at June 30, 2017 in the amount of approximately \$158.6 million (\$1.3 million recognized during fiscal year 2017, representing new deposits received in the year). Prior year's accrued interest receivable that had been impaired in the amount of \$3.5 million were capitalized into these deposits during fiscal year 2017 and interest income that had been recognized and capitalized on these cash and deposits during fiscal year 2017 in the amount of \$1.5 million were also reversed; therefore, explaining the custodial credit loss of \$158.6 million at June 30, 2017, presented in the corresponding table above. During the year ended June 30, 2017, the Tourism Development Fund had accrued approximately \$946 thousand in interest that was reversed from interest income as such accrual was also considered impaired.

The Other Non-major Funds have recognized custodial credit losses on its cash and deposits with the Bank at June 30, 2017 in the amount of \$13,304,478 (including \$248 thousand recognized during fiscal year 2017, representing new deposits received in the year by the Development Fund; and \$2.4 million representing restatement in the Puerto Rico Higher Education Fund for impairments that should have been recognized in the previous fiscal year). Also, interest income that had been recognized and capitalized into these deposits during fiscal year 2017 in the amount of \$50,532 were reversed (\$130 by JMB Institute, \$1,206 by Public Finance Corporation, \$2,127 by Puerto Rico Higher Education Assistance Corporation and \$47,069 by Development Fund), explaining the custodial credit loss of \$13,304,478 at June 30, 2017. During the year ended June 30, 2017, the Development Fund had accrued approximately \$28 thousand in interest that was reversed from interest income as such accruals were also considered impaired.

As discussed in Notes 3 and 22, on November 29, 2018, the Bank completed the Qualifying Modification provisions pursuant Title VI of PROMESA. This approved restructuring will require, during fiscal year 2019 as it is executed, certain offsets between financial instruments assets and liabilities held by the Bank; therefore, some of the recorded custodial credit losses disclosed above on the deposits held with the GDB Operating Fund would subsequently reverse.

*Custodial Credit Loss on Deposits at EDB*

In the case of EDB, due to the economic deterioration affecting the Puerto Rico government, including downgrades in credit ratings of the Commonwealth's bonds, the private sector retired deposits and exercised their put options on notes payable from EDB. Also, the GDB financial and liquidity crisis made public governmental agencies and corporations move their deposits from EDB to GDB, reducing EDB's capacity to issue commercial loans or make investments in financial instruments. In addition to these factors, the investments held by EDB declined in value and EDB operated only on the interest income generated by its loan's portfolio. This posed a difficult liquidity situation for EDB, because due to the high default rate on its loans portfolio, the ability to raise cash through loan repayments was limited. Therefore, the Bank's intent and ability to use its funds deposited with EDB have been significantly restricted. Based on the evaluation

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of the availability and recoverability of such deposits (all time deposits), a custodial credit loss on them has been recognized on the following Bank's fund and blended component units as follows:

Entity	Bank's Deposits held with EDB at June 30, 2017		
	Deposit Balance	Custodial Credit Loss	Book Balance
GDB Operating Fund:			
Overnight deposits	\$ 35,400,000	\$ (35,400,000)	\$ -
Time deposits	1,185,907	\$ (1,185,907)	-
Housing Finance Authority	\$ 65,242,680	\$ (65,242,680)	-
Tourism Development Fund	1,541,030	(1,541,030)	-
<b>Total</b>	<b>\$ 103,369,617</b>	<b>\$ (103,369,617)</b>	<b>\$ -</b>

The GDB Operating Fund has recognized custodial credit losses on its overnight and time deposits with EDB at June 30, 2017 in the amount of approximately \$36.6 million (none recognized during fiscal year 2017); however, interest income that had been recognized on these overnight and time deposits during fiscal year 2017 in the amount of approximately \$469,000 was reversed.

The Housing Finance Authority, a blended component unit of the Bank, was audited by another auditor and issued its 2017 stand-alone financial statements with a custodial credit loss recognition on its cash and deposits with EDB of \$64.8 million in its proprietary fund and \$478 thousand in its governmental funds (corresponding to the Affordable Housing Subsidy Program) at June 30, 2017, all attributed to fiscal year 2016, as restated and disclosed in Note 5. Of these amounts, approximately \$567 thousand consisted of accrued interest receivable that were capitalized during fiscal 2017. During the year ended June 30, 2017, the Housing Finance Authority had accrued approximately \$23 thousand in interest that was reversed from interest income as such accrual was also considered impaired.

The Tourism Development Fund has recognized custodial credit losses on its cash and deposits with EDB at June 30, 2017 in the amount of \$1,541,030 (none recognized during fiscal year 2017). Prior year's accrued interest receivable that had been impaired in the amount of \$9,030 was capitalized into these deposits during fiscal year 2017 and interest income that had been recognized and capitalized on these cash and deposits during fiscal year 2017 in the amount of \$7,294 were also reversed; therefore, explaining the custodial credit loss of \$1,541,030 at June 30, 2017. During the year ended June 30, 2017, the Tourism Development Fund had accrued \$14,197 in interest that was reversed from interest income as such accrual was also considered impaired.

**(7) Investments**

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

- U.S. government and agencies obligations
- Certificates of deposit and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth, its public entities, and municipalities
- Federal funds sold
- Securities purchased under agreements to resell

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- World Bank securities
- Mortgage-backed and asset-backed securities
- Corporate debt, including investment contracts
- External investment pools
- Stock of corporations created under the laws of the United States of America or the Commonwealth
- Options, futures, and interest-rate swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products which qualify under any of the foregoing investment categories
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or its equivalent by Moody's Investors Services

The Bank's investment policies establish limitations and other guidelines on maturities and amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policies provide guidelines on the institutions with which investment transactions can be entered into. In addition, the Risk Management Committee ("RMC"), formerly known as the Asset Liability Management Committee ("ALCO") and the board of directors of the Bank will determine, from time to time, other transactions that the Bank may enter into.

**Credit Risk** – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Bank's investment policies provide that investment transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by Standard & Poor's or equivalent rating by Moody's Investors Service or Fitch Ratings (Fitch), depending on the type and maturity of the investment and the counterparty to the transaction. Any exceptions must be approved by the Bank's board of directors. The investment policies also provide that purchases and sales of investment securities shall be made using the delivery versus payment procedures.

**Interest Rate Risk** – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Bank's investment policies also provide that the RMC is responsible for implementing and monitoring the Bank's interest rate risk policies and strategies. The RMC meets on a monthly basis to coordinate and monitor the interest rate risk management of interest sensitive assets and interest sensitive liabilities, including matching of their anticipated level and maturities, consistent with the Bank's liquidity, capital adequacy, risk and profitability goals set by the Bank's board of directors.

The following table summarizes the type and maturities of investments held by the Bank at June 30, 2017. Investments by type in any one issuer representing 5% or more of total investments of either the Bank or its blended component units have been separately disclosed. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.



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Investment type	Within one year	After one to five years	After five to ten years	After ten years	Total
U.S. sponsored agencies notes:					
Federal Home Loan Bank ("FHLB")	\$ 10,583,792	8,783,206	-	-	\$ 19,366,998
U.S. Treasury Obligations	303,861	-	-	-	303,861
Mortgage and asset-backed securities:					
Government National Mortgage Association ("GNMA")	-	-	38,500,860	39,426,979	77,927,839
Federal National Mortgage Association ("FNMA")	-	-	2,022,224	1,352,366	3,374,590
Other	-	-	-	170,831	170,831
External investment pools:					
Federated Government Obligations	-	-	-	13,693,967	13,693,967
Puerto Rico Government Investment Trust Fund	104,012,929	-	-	-	104,012,929
Israel Aid bonds	-	36,995,162	-	-	36,995,162
Nonparticipating investment contracts:					
Trinity Funding Co	-	-	-	14,279,373	14,279,373
Citibank, N.A.	-	-	-	17,628,800	17,628,800
Banco Popular de Puerto Rico	-	-	-	5,425,803	5,425,803
Banco Santander Puerto Rico	-	-	-	5,492,928	5,492,928
Total investments	<u>\$ 114,900,582</u>	<u>45,778,368</u>	<u>40,523,084</u>	<u>97,471,047</u>	<u>298,673,081</u>
Preferred securities/interest:					
Grupo Hima San Pablo					1,735,908
Other					4,500
Total					<u>\$ 300,413,489</u>

Total investments in fixed-income external investment pools were approximately \$117.7 million. These investments include approximately \$104 million invested in the Puerto Rico Government Investment Trust Fund, a government-sponsored 2a-7 like pool, which is administered by the Bank. This pool is not subject to regulation or registration under either the Investment Company Act of 1940 or the Securities and Exchange Act of 1933; however, it is subject to regulatory oversight by the Commissioner of Financial Institutions of Puerto Rico. The fair value of the pool is the same as the net asset value (NAV) of the pool shares. In addition, approximately \$13.7 million were invested in Federated Government Obligations with an average maturity of ten years or more. The Bank, through the Tourism Development Fund and the Development Fund, also invests in venture capital through external pools or direct investment in equity securities. The Bank's investment in these types of securities are not rated by a nationally recognized statistical rating organization and the related credit risk is measured through credit analysis, periodic reviews of results of operations and meetings with subject companies' management. In addition, an allowance for possible losses in venture capital investments is recorded as measure of providing a fair value in the financial statements.

During fiscal year 2013, the Tourism Development Fund entered into an agreement with a third party to redeem its investment in class B preferred special interest in Desarrolladora Del Norte, S. en C. for \$32 million in cash and an \$8 million non-interest-bearing promissory note. The non-interest-bearing promissory note requires annual payments of \$800,000 through June 2023. The Tourism Development Fund will forebear these annual payments if Desarrolladora Del Norte, S. en C. maintains its hotels operations in Puerto Rico with approximately 600 employees and complies with other requirements during the term of the contract. Management of the Tourism Fund understand that the collection of the promissory note is contingent on future events, therefore, the amounts under such promissory note will be recognized once they are collected. No collections were recorded during the year ended June 30, 2017.

Also, at June 30, 2017, substantially all of the Bank's investments in mortgage and asset-backed securities were held by trustees in connection with bonds issued by the Housing Finance Authority (approximately \$114.3 million at June 30, 2017), the terms of which generally provide for early redemption of the bonds if the securities are repaid early.

During the year ended June 30, 2017, proceeds from sales and redemption of investments from all the proprietary funds amounted to approximately \$55.4 million. There were no gains or losses on the sale and redemption of investments during fiscal year 2017. Purchases of investments during the year ended June 30, 2017, amounted to approximately \$93.3 million.

All the Bank's investments in U.S. Treasury securities, mortgage-backed securities guaranteed by GNMA, and Israel Aid Bonds carry the explicit guarantee of the U.S. government. The credit quality ratings for investments in debt securities,

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excluding U.S. Treasury securities, mortgage-backed securities guaranteed by GNMA, and Israel Aid Bonds, at June 30, 2017, are as follows:

Securities type	Credit Risk Rating <sup>(1)</sup>			Total
	AAA to A-	BBB	B	
U.S. sponsored agencies notes:				
FHLB	\$ 19,366,998	-	-	\$ 19,366,998
Mortgage and asset-backed securities				
FNMA	3,374,590	-	-	3,374,590
Other	170,831	-	-	170,831
External investment pools:				
Federated Government Obligations	13,693,967	-	-	13,693,967
Puerto Rico Government Investment Trust Fund	104,012,929	-	-	104,012,929
Non-participating investment contracts	37,401,101	-	5,425,803	42,826,904
<b>Total</b>	<b>\$ 178,020,416</b>	<b>\$ -</b>	<b>\$ 5,425,803</b>	<b>\$ 183,446,219</b>

<sup>(1)</sup> Rating obtained from Standard & Poor's or equivalent rating by Moody's Investor Service or Fitch Rating.

The credit quality ratings of non-participating investment contracts are based on the credit quality ratings at June 30, 2017, of the counterparties with whom these contracts are entered into. The credit quality ratings of the counterparties follow the ratings required by the investment policies of the Bank.

At June 30, 2017, the fair value of the Bank's investments based on the hierarchy of inputs is as follows:

Investment type	Level 1	Level 2	Level 3	Total
U.S. sponsored agencies notes:				
Federal Home Loan Bank ("FHLB")	\$ 19,366,998	-	-	\$ 19,366,998
U.S. Treasury Obligations	303,861	-	-	303,861
Mortgage and asset-backed securities:				
Government National Mortgage Association ("GNMA")	77,927,839	-	-	77,927,839
FNMA	3,374,590	-	-	3,374,590
Other	170,831	-	-	170,831
External investment pools-Federated				
Government Obligations	13,693,967	-	-	13,693,967
Israel Aid bonds	36,995,162	-	-	36,995,162
Preferred securities/interest	-	-	1,740,408	1,740,408
Total investments measured at fair value	<b>\$ 151,833,248</b>	<b>\$ -</b>	<b>\$ 1,740,408</b>	<b>153,573,656</b>
Investments not measured at fair value:				
Puerto Rico Government Investment Trust Fund (at NAV)				104,012,929
Nonparticipating investment contracts (at amortized cost)				42,826,904
<b>Total investments</b>				<b>\$ 300,413,489</b>

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**(8) Loans Receivable and Allowance for Loan Losses**

At June 30, 2017, loans consist of the outstanding balance of credit facilities granted to the following (in thousands):

	<b>GDB Operating Fund <sup>(1)</sup></b>	<b>Tourism Development Fund</b>	<b>Housing Finance Authority</b>	<b>Housing Development Fund</b>	<b>Total</b>
Public corporations and agencies	\$ 6,357,206	\$ -	\$ -	\$ -	\$ 6,357,206
Municipalities	2,202,826	-	-	-	2,202,826
Allowance for loan losses	(5,847,836)	-	-	-	(5,847,836)
Net loans to public sector	2,712,196	-	-	-	2,712,196
Private sector	901	107,563	221,596	26,800	356,860
Allowance for loan losses	(333)	(72,948)	(28,565)	(26,800)	(128,646)
Net loans to private sector	568	34,615	193,031	-	228,214
Total loans receivable, net	<u>\$ 2,712,764</u>	<u>\$ 34,615</u>	<u>\$ 193,031</u>	<u>\$ -</u>	<u>\$ 2,940,410</u>

<sup>(1)</sup> Excluding loans to component units.

**(a) Public Corporations and Agencies**

Loans to the public sector, excluding municipalities, amounted to approximately \$6.4 billion at June 30, 2017. Loans to the Commonwealth and its public entities typically include working capital lines of credit payable from short-term tax and revenue anticipation notes issued by the Bank to finance the short-term liquidity needs of the Commonwealth, interim financing of capital improvements payable from Commonwealth's general obligation bonds or revenue bonds issued by the corresponding agency and, in recent years, loans to finance the Commonwealth's budget deficit previously payable from COFINA and currently payable from debt appropriations, uncollected taxes and annual appropriations made by the Legislature.

At June 30, 2017, loans to public corporations and agencies of the Commonwealth amounting to \$6,357,206, are repayable from the following sources (in thousands):

<b>Repayment Source</b>	<b>Amount</b>
Proceeds from future bond issuances	\$ 1,504,300
General fund and/or legislative appropriations	3,372,180
Operating revenues	1,132,986
Other	347,740
	<u>\$ 6,357,206</u>

For the year ended June 30, 2017, there were no disbursements or collections of principal of public sector loans with future bond issuances as the source of repayment. Public sector loans with Commonwealth's General fund and/or appropriations as source of repayment had collections of principal amounting to approximately \$22.7 million but had no disbursements during the year ended June 30, 2017. Public sector loans with operating revenue and other as a source of repayment had disbursements and collections of principal amounting to approximately \$4.3 million and \$8.9 million, respectively, during the year ended June 30, 2017.

On May 23, 2016, former governor Alejandro García Padilla proposed a \$9.1 billion budget for fiscal year 2017. The proposed budget included an appropriation for the payment of the Commonwealth's debts with the Bank in the amount of \$375 million. However, such appropriation was not approved by the Legislative Assembly. Rather, the approved budget included appropriations in an aggregate amount of approximately \$235 million, distributed through several items, segregated between approximately \$132.5 million cash appropriation that was required to be applied as payment of principal and interest of the Commonwealth's debts to the Bank, which explains the collection of public sector loans

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referred to in the previous paragraph; and approximately \$102.5 million appropriated for the operational and program needs of different components units of the Commonwealth and disbursed to those component units, but at the same time to be applied as a non-cash application to the principal of certain of the Commonwealth's lines of credit debt with the Bank (treated for accounting purposes as a write-off in fiscal year 2017 of loans that had been already fully reserved in previous years).

At June 30, 2017, approximately \$3.4 billion of the public-sector loans are payable from legislative appropriations, or future tax revenues of, the Commonwealth. Accordingly, the payment of these loans is affected by budgetary constraints associated with the current economic and fiscal situation impacting Puerto Rico. As further disclosed in Note 22, the approved budget by the Legislative Assembly for fiscal years 2018 and 2019 did not include appropriations for the payment of debt service by the Commonwealth and its public corporations.

The following is a summary of public sector loans considered to be impaired as of June 30, 2017, and the related interest income for the year then ended (in thousands):

	<b>GDB</b>
	<b>Operating</b>
	<b>Fund (in thousands)</b>
Recorded investment in impaired loans:	
Not requiring an allowance for loan losses	\$ 326,188
Requiring an allowance for loan losses	5,904,115
Total recorded investment in impaired loans	<u>\$ 6,230,303</u>
Related allowance for loan losses	\$ 5,774,453
Average recorded investment in impaired loans	\$ 6,294,150
Interest income recognized on impaired loans	\$ 120,699

As of June 30, 2017, the majority of loans to public corporations and agencies totaling \$6.4 billion has been classified in non-accrual status. Interest income that would have been recorded if such non-accrual loans had been accruing in accordance with their original terms was approximately \$400 million in fiscal year 2017.

The Bank evaluation of impaired loans consisted in identifying which public sector loans have reliable sources of repayment and which have unreliable sources of repayment. Loans with reliable sources of repayment that were performing were evaluated collectively. Loans with unreliable sources of repayment were evaluated for impairment individually. Impaired loans are measured individually based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral, if the loan is collateral dependent.

During fiscal year 2017, the Bank recognized a provision for loan losses of approximately \$5.7 million in its public corporations and agencies loan portfolio to end up with an allowance for loan losses of approximately \$5.774 billion at June 30, 2017.

**(b) Municipalities Loans**

Loans to municipalities amounted to approximately \$2.2 billion at June 30, 2017. For the year ended June 30, 2017, municipal sector loan disbursements and collections amounted to approximately \$1 million and \$110.4 million, respectively.

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The following table provides the sources of repayment of the loans to municipalities:

	<b>Principal</b> <b>(in thousands)</b>
Repayment source:	
Collections of property tax	\$ 1,308,473
Collections of municipal sales and use tax	486,558
Operating revenues and other	<u>407,795</u>
Total	<u>\$ 2,202,826</u>

These loans include approximately \$1.3 billion at June 30, 2017, which are collateralized by a pledge of a portion of property tax assessments of each municipality. Loans pledged with property tax assessments include bonds and notes issued by Puerto Rico municipalities which are originated by the Bank as bridge financing until such financings can be completed.

Loans to municipalities include approximately \$487 million at June 30, 2017, which are collateralized by a pledge of a portion of the municipal sales tax, which is deposited in special accounts with the Bank for the purpose of granting such loans to municipalities. The funds available in such accounts increase the borrowing capacity of the corresponding municipality.

Loans to municipalities include approximately \$408 million at June 30, 2017, which were provided mainly as interim loans to finance capital expenditures that are payable from revenues to be generated from a specific revenue generating project associated with the loan or to cover operating losses. Once operating loans are approved and if the municipality is not servicing the debt with its own funds, the Bank informs the Municipal Revenue Collection Center (CRIM for its Spanish acronym) in order to withhold property taxes revenues and remit them directly to the Bank before they are distributed to the municipalities. Municipality loans amounting to approximately \$36.5 million as of June 30, 2017, were identified as delinquent. No interest was collected on these loans during the year ended June 30, 2017.

During the fiscal year 2017, the Bank recognized a release of provision for loan losses of approximately \$4 million in its municipal loans portfolio to end up with an allowance for loan losses of approximately \$73.4 million at June 30, 2017.

The following is a summary of municipal loans considered to be impaired as of June 30, 2017, and the related interest income for the year then ended (in thousands):

	<b>GDB</b> <b>Operating</b> <b>Fund (in thousands)</b>
Recorded investment in impaired loans:	
Not requiring an allowance for loan losses	\$ 168,135
Requiring an allowance for loan losses	<u>89,717</u>
Total recorded investment in impaired loans	<u>\$ 257,852</u>
Related allowance for loan losses	\$ 73,383
Average recorded investment in impaired loans	\$ 307,835
Interest income recognized on impaired loans	\$ 2,811

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(c) **Private Sector Loans**

Loans to the private sector include the outstanding principal balance of credit facilities granted by the Bank, the Tourism Development Fund and the Development Fund to private enterprises in Puerto Rico, the activities of which are deemed to further the economic and tourism development of Puerto Rico. Loans to the private sector also include the outstanding principal balance of mortgage loans granted by Housing Finance Authority to low and moderate-income families for the acquisition of single-family housing units and to developers of low and moderate-income multifamily housing units in Puerto Rico. These credit facilities, net of allowance for loan losses, amounted to approximately \$228.2 million at June 30, 2017, of which approximately \$193 million are mortgage loans for low and moderate-income housing units, approximately \$34 million are for tourism projects and approximately \$1 million are manufacturing loans.

During fiscal year 2013, the Tourism Development Fund sold a loan receivable to a third party for \$50 million, of which \$40.7 million was paid upon signing of the agreement. Tourism Development Fund agreed to write off any remaining loan balance as long as the buyer continued the development of certain tracks of land. The remaining \$9.3 million under the sales contract will be paid contingent on future events until December 31, 2017. Based on the contingent nature on the collection of the remaining balance, such amount was not recognized as receivable; instead, income will be recognized in the year it is collected. As of June 30, 2017, the Tourism Development Fund has collected \$4.5 million on such contingency (none during the year ended June 30, 2017).

Private sector loans classified as nonaccrual amounted to approximately \$158.6 million at June 30, 2017. Interest income that would have been recorded if these loans had been performing in accordance with their original terms was approximately \$19.6 million in 2017.

The following is a summary of private sector loans considered to be impaired as of June 30, 2017, and the related interest income for the year then ended (in thousands):

	<b>GDB Operating Fund</b>	<b>Tourism Development Fund</b>	<b>Housing Finance Authority</b>	<b>Development Fund</b>	<b>Total</b>
Recorded investment in impaired loans:					
Not requiring an allowance for loan losses	\$ -	\$ -	\$ 5,260	\$ -	\$ 5,260
Requiring an allowance for loan losses	333	107,563	15,253	26,800	149,949
Total recorded investment in impaired loans	<u>\$ 333</u>	<u>\$ 107,563</u>	<u>\$ 20,513</u>	<u>\$ 26,800</u>	<u>\$ 155,209</u>
Related allowance for loan losses	<u>\$ 333</u>	<u>\$ 72,949</u>	<u>\$ 16,565</u>	<u>\$ 26,800</u>	<u>\$ 116,647</u>
Average recorded investment in impaired loans	<u>\$ 344</u>	<u>\$ 107,800</u>	<u>\$ 24,587</u>	<u>\$ 26,800</u>	<u>\$ 159,531</u>
Interest income recognized on impaired loans	<u>\$ -</u>	<u>\$ 681</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 681</u>

In the case of the Housing Finance Authority, an additional general reserve of \$12 million was provided on its second mortgage loans originated by private banking institutions under the requirements of the Puerto Rico Economic Stimulus Plan Act. The loans under this program do not collect principal and interest until after the first ten years of the term of the loans, thus, not considered impaired; however, a general reserve was provided based on the similar experience on other similar loans.

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The following is an overall summary of the activity in the allowance for loan losses for the year ended June 30, 2017 (in thousands):

	<b>Proprietary Funds</b>				
	<b>GDB</b>	<b>Tourism</b>	<b>Housing</b>		
	<b>Operating</b>	<b>Development</b>	<b>Finance</b>	<b>Development</b>	<b>Total</b>
	<b>Fund</b>	<b>Fund</b>	<b>Authority</b>	<b>Fund</b>	
Balance – beginning of year	\$ 5,842,467	\$ 73,696	\$ 34,258	\$ 26,800	\$ 5,977,221
Provision (release) of loan losses	108,157	(748)	(4,102)	-	103,307
Write-offs	(102,455)	-	(1,591)	-	(104,046)
Balance – end of year	<u>\$ 5,848,169</u>	<u>\$ 72,948</u>	<u>\$ 28,565</u>	<u>\$ 26,800</u>	<u>\$ 5,976,482</u>

**(9) Due from Federal Government**

The Housing Finance Authority, as a public housing agency, is authorized to administer the U.S. Housing Act Section 8 Programs in Puerto Rico. The revenues and expenses of such federal financial assistance are accounted for as a major governmental fund under the HUD Programs fund. Revenues and expenditures related to the administration of the U.S. Housing Act Section 8 Programs amounted to approximately \$149.8 million during the year ended June 30, 2017. This amount includes approximately \$4.9 million of administrative fees for services performed as contract administrator, which are reimbursed by HUD. As of June 30, 2017, the amounts due from federal government under the HUD Programs fund amounted to approximately \$1 million.

During the year ended June 30, 2017, the Housing Finance Authority expended approximately \$14.7 million of HOME Program funds. The Housing Finance Authority has approximately \$5.3 million due from the federal government as of June 30, 2017 related to the HOME Program.

The New Secure Housing Program (the “NSH Program”) constituted an inter-governmental effort to provide long-term hazard mitigation assistance to the Commonwealth by providing funding for relocation of eligible participants who were affected by Hurricane Georges in 1998 or who lived in hazard-prone areas under the Federal Emergency Management Agency Hazard Mitigation Grant Program (HMGP). Through a series of collaborative agreements, the Office of the Governor’s Authorized Representative (the GAR) was named the grantee, the Puerto Rico Department of Housing (the “Department of Housing”) was named the sub-grantee, and the Housing Finance Authority was named the administrator of the NSH Program. Under the NSH Program, the Housing Finance Authority was responsible for project management, including contracting, supervising and paying the designers, inspectors, and legal services needed for the NSH Program. The Housing Finance Authority also provided all funding for the NSH Program through a \$67 million nonrevolving line of credit with the Bank; and for land acquisitions, awarding construction contracts, qualifying participants, and selling housing units to eligible participants.

Under the terms of the grant, the construction of, and relocation of participants into new secure housing facilities was to be completed by December 31, 2007. In addition, FEMA would reimburse 75% of the allowable costs of the NSH Program. Funds collected under the NSH Program, since its inception, amounted to approximately \$113 million. In April 2007, FEMA discontinued reimbursing the Housing Finance Authority’s allowable costs based on the NSH Program’s non-compliance with the scheduled dates for construction activities and case management. The Department of Housing requested various extensions and reconsiderations; the last one up to June 30, 2010 and FEMA granted such requests. Although significant progress was made through June 30, 2010, in the construction activities and in the case management of the NSH Program, the Housing Finance Authority was not able to fully comply with the terms of the extensions granted by FEMA. On September 30, 2011, the Housing Finance Authority provided FEMA and the GAR, the NSH Program’s closeout documentation which was reviewed by FEMA.

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On January 30, 2012, the Housing Finance Authority and the Department of Housing entered into a transition agreement by which the Department of Housing would assume its obligations as the NSH Program sub-grantee and project owner, including vacant property dispositions, open space monitoring and other related matters. The Housing Finance Authority continues to assume the amounts payable under the \$67 million nonrevolving line of credit with the Bank, until such debt can be assumed by the Commonwealth. The Department of Housing would prospectively assume, without recourse, any additional funds that might be requested by FEMA for events of noncompliance, including related costs. The outstanding balance at June 30, 2017 of the aforementioned nonrevolving facility with the Bank is approximately \$45.8 million, included as long-term debt in governmental activities.

Based on all these facts and that no reimbursements have been received from FEMA since April 2007, management has decided to establish an allowance for the \$26 million due from FEMA at June 30, 2017.

**(10) Real Estate Available for Sale**

Real estate available for sale at June 30, 2017, at fair value, consisted of the following:

	<u>Proprietary Funds</u>		
	<u>GDB</u>	<u>Housing</u>	<u>Total</u>
	<u>Operating</u>	<u>Finance</u>	
	<u>Fund</u>	<u>Authority</u>	
Residential (1-4 units)	\$ -	2,882,712	2,882,712
Commercial	57,057,752	-	57,057,752
Total real estate available for sale	<u>\$ 57,057,752</u>	<u>\$ 2,882,712</u>	<u>\$ 59,940,464</u>

During fiscal year 2009, the GDB Operating Fund entered into an interagency agreement with a public entity of the Commonwealth whereby the Bank received several properties with appraised values (based on appraisals made near the transaction date) of \$155.9 million in lieu of payment of a loan whose principal balance and accrued interest receivable amounted to \$144.2 million at December 30, 2008. The interagency agreement provided that the agency of the Commonwealth would transfer to the Bank additional properties to cover any deficiency in the properties' values during a period of five years. On November 20, 2013, the agreement was extended until December 30, 2018. As part of such agreement, any subsequent loss or reduction of fair value shall be repaid by the Commonwealth or one of its agencies or component units. As of June 30, 2017, total receivable of \$75.2 million, related to the losses or reductions in fair value from the aforementioned properties, was considered uncollectible and fully reserved.

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**(11) Capital Assets**

Capital assets activity for the year ended June 30, 2017, was as follows:

	<b>Governmental activities</b>			
	<b>Beginning balance</b>	<b>Additions</b>	<b>Reductions/ reclassifications</b>	<b>Ending balance</b>
Capital assets:				
Information systems	\$ 66,329	\$ -	\$ -	\$ 66,329
Office furniture and equipment	37,633	-	-	37,633
Vehicles	66,135	-	-	66,135
Total capital assets	<u>170,097</u>	<u>-</u>	<u>-</u>	<u>170,097</u>
Less accumulated depreciation and amortization for:				
Information systems	(66,307)	-	-	(66,307)
Office furniture and equipment	(36,336)	(733)	-	(37,069)
Vehicles	(66,132)	-	-	(66,132)
Total accumulated depreciation	<u>(168,775)</u>	<u>(733)</u>	<u>-</u>	<u>(169,508)</u>
Capital assets governmental activities – net	<u>\$ 1,322</u>	<u>\$ (733)</u>	<u>\$ -</u>	<u>\$ 589</u>
	<b>Business type – activities</b>			
	<b>Beginning balance</b>	<b>Additions/ reclassifications</b>	<b>Reductions/ reclassifications</b>	<b>Ending balance</b>
Capital assets not being depreciated:				
Land	\$ 11,725,000	\$ 472,712	\$ (2,845,000)	\$ 9,352,712
Land under development	14,100,000	91,314	(91,314)	14,100,000
Total capital assets not being depreciated	<u>25,825,000</u>	<u>564,026</u>	<u>(2,936,314)</u>	<u>23,452,712</u>
Capital assets being depreciated:				
Leasehold improvements	4,516,380	19,825	(237,812)	4,298,393
Information systems	6,001,816	82,628	(823,328)	5,261,116
Office furniture and equipment	2,717,722	9,678	(239,829)	2,487,571
Software	500,555	-	(127,418)	373,137
Vehicles	244,597	29,900	(1)	274,496
Total capital assets being depreciated	<u>13,981,070</u>	<u>142,031</u>	<u>(1,428,388)</u>	<u>12,694,713</u>
Less accumulated depreciation and amortization for:				
Leasehold improvements	(3,984,596)	(229,512)	237,812	(3,976,296)
Information systems	(4,830,349)	(523,853)	501,883	(4,852,319)
Office furniture and equipment	(2,571,893)	(70,344)	239,829	(2,402,408)
Software	(206,620)	(161,322)	127,418	(240,524)
Vehicles	(191,218)	(19,209)	1	(210,426)
Total accumulated depreciation and amortization	<u>(11,784,676)</u>	<u>(1,004,240)</u>	<u>1,106,943</u>	<u>(11,681,973)</u>
Total capital assets being depreciated – net	<u>2,196,394</u>	<u>(862,209)</u>	<u>(321,445)</u>	<u>1,012,740</u>
Capital assets business type activities – net	<u>\$ 28,021,394</u>	<u>\$ (298,183)</u>	<u>\$ (3,257,759)</u>	<u>\$ 24,465,452</u>
Total capital assets – net				<u>\$ 24,466,041</u>

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As a result of the enactment of Act No. 29 of May 23, 2017, known as the Act for the Trust of the Puerto Rico Art Museum (Museum Trust), all personal and real property, including files, records and documents related to the Museum that may have been maintained by the Bank, were required to be transferred to such Museum Trust. Consequently, upon the enactment of the aforementioned Act, the Bank transferred to the Museum Trust certain land with a carrying value of \$2,845,000.

During fiscal year ended June 30, 2017, the Bank recorded long-lived assets impairment charges totaling approximately \$91,314, related to a land under development. In December 1997, the Corporación Renovación Urbana y Vivienda (“CRUV”) transferred to the Bank certain properties with an approximate fair value of \$37.8 million (as appraised in 1997) in exchange for a debt cancellation. One of the properties received was Finca Rosso or Comunidad Río Bayamón Norte (hereinafter “CRBN”). Specifically, as part of its functions of furthering the economic development of Puerto Rico, the Bank was developing the infrastructure and public spaces of the CRBN as per a Master Plan. However, since fiscal year 2014, the Bank determined that the changes in circumstances associated with the service use of the property dramatically changed and thus recorded the aforementioned impairment related to costs incurred on the property which had been capitalized.

**(12) Deposits**

Deposits consist predominantly of interest-bearing demand accounts, special government deposit accounts, and time deposits from the Commonwealth, and its public entities. Interest expense on these deposits amounted to approximately \$47 million during fiscal year 2017.

**(13) Bonds, Notes, and Mortgage-Backed Certificates Payable, and Other Liabilities**

The activity of bonds payable and other borrowed funds for the year ended June 30, 2017, is as follows:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Governmental activities –					
Commonwealth appropriation bonds and notes - note payable - AHMSP Act No. 124	\$ 3,397,686	\$ -	\$ -	\$ 3,397,686	\$170,073
Less unaccreted discount	(64,072)	2,644	-	(61,428)	-
Total governmental activities	<u>\$ 3,333,614</u>	<u>\$ 2,644</u>	<u>\$ -</u>	<u>\$ 3,336,258</u>	<u>\$170,073</u>

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	Beginning balance	Additions	Reductions	Ending balance	Due within one year
<b>Business-type activities:</b>					
<b>GDB Operating Fund:</b>					
Senior Notes 2006 Series B	\$ 29,830,000	-	\$ -	\$ 29,830,000	\$ 29,830,000
Senior Notes 2010 Series A	433,702,000	-	-	433,702,000	-
Senior Notes 2010 Series B	151,259,000	-	-	151,259,000	-
Senior Notes 2010 Series C	217,715,000	-	-	217,715,000	-
Senior Notes 2010 Series D	96,411,000	-	-	96,411,000	-
Senior Notes 2011 Series B	360,010,000	-	-	360,010,000	360,010,000
Senior Notes 2011 Series H	1,259,070,000	-	-	1,259,070,000	226,855,000
Senior Notes 2011 Series I	317,935,000	-	-	317,935,000	-
Senior Notes 2012 Series A	750,000,000	-	-	750,000,000	250,000,000
Senior Notes 2013 Series B	110,000,000	-	-	110,000,000	40,000,000
Senior Notes 2016 Series A	39,990,000	-	-	39,990,000	39,990,000
Add (deduct) unamortized premium (discount)	(2,985,337)	-	1,385,525	(1,599,812)	9,107
<b>Total GDB Operating Fund</b>	<b>3,762,936,663</b>	<b>-</b>	<b>1,385,525</b>	<b>3,764,322,188</b>	<b>946,694,107</b>
<b>Housing Finance Authority:</b>					
Mortgage Trust III	88,265,002	-	(25,015,000)	63,250,002	15,890,002
<b>Revenue bonds:</b>					
Single Family Mortgage Revenue Bonds – Portfolio XI	13,800,000	-	(13,800,000)	-	-
Mortgage-Backed Certificates 2006 Series	69,716,833	-	(6,594,478)	63,122,355	12,646,368
<b>Total revenue bonds</b>	<b>83,516,833</b>	<b>-</b>	<b>(20,394,478)</b>	<b>63,122,355</b>	<b>12,646,368</b>
<b>Subtotal</b>	<b>171,781,835</b>	<b>-</b>	<b>(45,409,478)</b>	<b>126,372,357</b>	<b>28,536,370</b>
<b>Notes payable</b>					
Special obligation notes (Home Purchase Stimulus Program)	73,980,673	-	(1,367,347)	72,613,326	-
Plus unamortized premium	275,331	-	(34,356)	240,975	-
Less unaccrued discount	(39,230,078)	-	8,737,826	(30,492,252)	-
<b>Total notes payable</b>	<b>35,025,926</b>	<b>-</b>	<b>7,336,123</b>	<b>42,362,049</b>	<b>-</b>
<b>Total Housing Finance Authority</b>	<b>206,807,761</b>	<b>-</b>	<b>(38,073,355)</b>	<b>168,734,406</b>	<b>28,536,370</b>
<b>Tourism Development Fund:</b>					
Participation agreement payable	21,955,556	-	-	21,955,556	1,877,778
<b>Total Tourism Development Fund</b>	<b>21,955,556</b>	<b>-</b>	<b>-</b>	<b>21,955,556</b>	<b>1,877,778</b>
<b>Total business-type activities</b>	<b>3,991,699,980</b>	<b>-</b>	<b>(36,687,830)</b>	<b>3,955,012,150</b>	<b>977,108,255</b>

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The annual debt service requirements to maturity, including principal and interest, for long-term debt, (excluding notes payable by component units to the Bank) as of June 30, 2017, are as follows:

<b>GDB Operating Fund</b>			
<b>Business-type activities</b>			
	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
Years ending June 30:			
2018	\$ 946,685,000	346,495,475	\$ 1,293,180,475
2019	847,935,000	127,904,052	975,839,052
2020	432,260,000	84,032,997	516,292,997
2021	433,702,000	59,199,593	492,901,593
2022	142,640,000	50,804,879	193,444,879
2023-2027	962,700,000	102,697,592	1,065,397,592
Total	<u>\$ 3,765,922,000</u>	<u>771,134,588</u>	<u>\$ 4,537,056,588</u>

The GDB Notes Series 2010 B and 2010D, which were issued as Build America Bonds where the Bank was receiving a subsidy payment from the federal government equal to 35% of the amount of each interest payment, continued receiving such subsidies until June 30, 2017 at which time, such subsidies ceased. As of June 30, 2017, such interest subsidies received and not paid amounted to \$1.2 million, held in a separate account and were subject to the Qualifying Modification process discussed in Notes 3 and 22.

<b>Housing Finance Authority</b>				
	<b>Governmental activities</b>		<b>Business-type activities</b>	
	<b>Principal</b>	<b>Interest</b>	<b>Principal</b>	<b>Interest</b>
Years ending June 30:				
2018	\$ 170,073	\$ 377,402	\$ 28,536,370	\$ 2,699,587
2019	89,716	183,906	31,783,327	2,325,485
2020	93,308	180,128	25,658,237	2,412,862
2021	97,171	176,020	9,743,978	3,424,941
2022	101,402	171,535	6,414,515	4,031,725
2023-2027	476,786	786,852	32,808,849	26,711,865
2028-2032	2,369,230	213,360	18,797,879	19,172,506
2033-2037	-	-	21,177,468	12,698,061
2038-2042	-	-	24,065,060	4,181,117
Total	<u>\$ 3,397,686</u>	<u>\$ 2,089,203</u>	<u>\$ 198,985,683</u>	<u>\$ 77,658,149</u>

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	<b>Tourism Development Fund <sup>(2)</sup></b>	
	<b>Business-type activities</b>	
	<b>Principal</b>	<b>Interest</b>
Years ending June 30:		
2018	\$ 1,877,778	\$ 1,326,998
2019	20,077,778	-
Total	<u>\$ 21,955,556</u>	<u>\$ 1,326,998</u>

<sup>(2)</sup>Debt service requirements of this variable-rate debt assume that the interest rate effective at June 30, 2017, remains the same throughout the term of the debt.

(a) **Governmental Activities**

Bonds and notes payable of governmental activities as of June 30, 2017, consists of the following:

<u>Description and maturity date</u>	<u>Interest rate</u>	<u>Amount outstanding</u>
Note payable AHMSP Act No. 124 due on August 1, 2016 and each August 1, thereafter to August 1, 2031	6%	\$ 3,336,258

*Note Payable to Puerto Rico Public Finance Corporation* – On December 27, 2001, the Housing Finance Authority entered into a loan agreement (the “Note”) with the GDB Operating Fund to refinance the AHMSP Stage 7 note payable of the Housing Finance Authority, as authorized by Act No. 164 of December 17, 2001. The Public Finance Corporation acquired and restructured the Note through the issuance of its Commonwealth appropriations bonds (the “PFC Bonds”). The PFC Bonds were issued under certain trust indentures whereby the Public Finance Corporation pledged the Note, along with other notes under Act No. 164, to certain trustees and created a first lien on the revenues of the notes sold (consisting of Commonwealth appropriations earmarked to repay these notes) for the benefit of the bondholders.

During June 2004, the Public Finance Corporation advance refunded a portion of certain of its outstanding Commonwealth appropriation bonds issued in 2001 under Act No. 164 of December 17, 2001. The Housing Finance Authority recognized a mirror effect of this advance refunding by the Public Finance Corporation on its own notes payable in proportion to the portion of the Housing Finance Authority’s note payable included in the Public Finance Corporation refunding. The aggregate debt service requirements of the refunding and unrefunded notes will be funded with annual appropriations from the Commonwealth.

The outstanding balance of this note at June 30, 2017, was \$3,336,258 and matures on August 1, 2031. Interest on the unpaid principal amount of the Note is equal to the applicable percentage of the aggregate interest payable on the PFC Bonds. The applicable percentage is the percentage representing the proportion of the amount paid by the Public Finance Corporation on the PFC Bonds serviced by the Note to the aggregate amount paid by the Public Finance Corporation on all the PFC Bonds issued by Public Finance Corporation under Act No. 164, which was 6% at June 30, 2017.

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(b) *Business-Type Activities*

Bonds, notes and mortgage-backed certificates payable of business-type activities consist of the following:

Description and maturity date	Interest rate	Carrying amount
GDB Senior Notes :		
Series 2006 B – Each December 1 until December 1, 2017	5.00%	\$ 29,839,107
Series 2010 A – August 1, 2020	5.50	433,702,000
Series 2010 B – August 1, 2025	5.75	151,259,000
Series 2010 C – August 1, 2019	5.40	217,715,000
Series 2010 D – August 1, 2025	5.75	96,411,000
Series 2011 B – May 1, 2016	4.70	360,010,000
Series 2011 H – August 1, 2017, August 1, 2019, Each August 1, from 2021 to 2023, and August 1, 2026	3.80–5.20	1,259,070,000
Senior 2011 I – August 1, 2018	4.35	317,112,579
Senior 2012 A – February 1, 2017 and February 1, 2019	3.875–4.375	749,213,502
Senior 2013 B – Each December 1, from 2017 to 2019	8.00	110,000,000
Senior 2016 A – November 1, 2016 and May 1, 2017	4.704	39,990,000
Mortgage Trust III:		
Each July 1 and January 1 until January 1, 2021	Zero Coupon	55,856,511
Mortgage-Backed Certificates, 2006 Series A – Principal and interest payable monthly from September 29, 2006 to August 29, 2030	2.95–6.56	58,412,556
Special Obligation Notes, 2010 Series A and B – Principal and interest payable monthly from July 1, 2019 to May 1, 2040	6.95–6.97	22,110,735
Special Obligation Notes, 2011 Series A – Principal and interest payable monthly from September 1, 2021 to September 1, 2041	7.00	12,310,645
Special Obligation Notes, 2012 Series A – Principal and interest payable monthly from June 18, 2012 to September 1, 2041	7.00	20,043,959
Participation Agreement Payable – Principal and interest payable monthly through July 1, 2018	7.00	21,955,556
Total		<u>\$ 3,955,012,150</u>

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(c) ***GDB Senior Notes***

Pursuant to Executive Order (EO) 2016-14, the Bank has already missed the following bond payments:

*GDB Senior Notes Series 2011B and 2016A*

On May 1, 2016, of the approximately \$409.4 million debt service (\$400 million in principal and \$9.4 million in interest) due on the GDB Notes Series 2011B, only interest of \$8.5 million was paid, with the entire principal amount due of \$400 million remaining unpaid. Of the \$400 million in principal due, \$39.9 million of these notes due to several state-chartered Puerto Rico cooperatives and credit unions were exchanged on May 1, 2016 (\$32.9 million) and on May 27, 2016 (\$7.1 million) for newly issued GDB notes (*GDB Notes Series 2016A*) maturing on May 1, 2017, which also were not paid upon its maturity. On May 1, 2017, the approximately \$41.9 million debt service (\$39.9 million in principal, \$940 thousand in interest that was due on November 1, 2016 and another \$940 thousand in interest that was due on May 1, 2017) remained unpaid.

*GDB Notes Series 2012A*

The required debt service due on August 1, 2016 (\$15.8 million in interest) and February 1, 2017 (\$250 million in principal and \$15.8 million in interest) remained unpaid.

*GDB Notes Series 2010A, 2010B, 2010C, 2010D, 2011H, 2011I, 2013B-1*

The monthly debt service due on these series of notes from August 1, 2016 through June 30, 2017 (aggregating \$122.8 million in interest) remained unpaid.

*GDB Notes Series 2006B*

The required debt service, due on December 1, 2016 (\$19.2 million in principal and \$746 thousands in interest) and on June 1, 2017 (\$265.9 thousands in interest) remained unpaid.

(d) ***Participation Agreement Payable***

On April 10, 2006, the Tourism Development Fund entered into a debt restructuring agreement with Hotel Dorado, S.E. (the "Hotel") whereby the Tourism Development Fund, as guarantor of the Hotel's outstanding bonds, accelerated the payment of the bonds in exchange for a note receivable of \$26 million from the Hotel. In addition, on April 10, 2006, the Tourism Development Fund entered into a participation agreement with a financial institution whereby the Tourism Development Fund transferred its 100% participation (the "Participation") in the note receivable.

The Participation is subject to recourse and the Tourism Development Fund is obligated to purchase the loan from the financial institution upon the occurrence and during the continuance of an event of default under the participation agreement. The participation agreement also stipulates that the financial institution cannot sell, pledge, transfer, assign or dispose of the Participation without the Tourism Development Fund's consent. Accordingly, the Tourism Development Fund has recorded the note receivable as part of loans receivable and has recorded a participation agreement payable (i.e. a collateralized borrowing) in the accompanying statement of net position (deficit) – proprietary funds.

The Participation bears a variable interest rate based on the three-month LIBOR plus 2.50%, until maturity on July 1, 2018. No payments were on this participation agreement payable during fiscal year 2017. The outstanding principal balance of the note receivable and the corresponding participation agreement payable remained at \$21.9 million as of June 30, 2017.

The participation agreement payable was subsequently settled on February 28, 2018 in a discounted pay-off transaction through a payment from the Tourism Development Fund in the amount of \$2,372,000, as further explained in Note 22. Therefore, before the end of fiscal year 2018, the scheduled maturities of this participation agreement payable will differ from the ones presented in the table referred to above under Tourism Development Fund.

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**(e) Non-Current Liabilities**

Non-current liabilities consist principally of the long-term portion payable of voluntary termination benefits, compensated absences and certain fees retention payable. The activity for non-current accounts payable and accrued liabilities of the business-type activities during the year ended June 30, 2017, follows:

Balance – beginning of period	\$ 19,933,167
Increases	<u>4,836,261</u>
Balance – end of period	<u>\$ 24,769,428</u>

The activity for compensated absences included within accounts payable and accrued liabilities during the year ended June 30, 2017, follows:

	<u>Beginning balance</u>	<u>Provision</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Vacation	\$ 2,046,622	\$ 2,039,195	\$ 2,648,831	\$ 1,436,986	\$ 1,383,008
Sick Leave	2,416,444	806,844	2,115,592	1,107,696	223,253
Total	<u>\$ 4,463,066</u>	<u>\$ 2,846,039</u>	<u>\$ 4,764,423</u>	<u>\$ 2,544,682</u>	<u>\$ 1,606,261</u>

No significant changes have been made during fiscal year 2017 to the Bank’s compensated absences policies for its employees. Amounts due within one year are estimated based on history of reductions.

**(14) Mortgage Loan Insurance Fund**

The Mortgage Loan Insurance Fund was created by Act No. 87 of June 25, 1965, as amended, known as the Mortgage Loan Insurance. This act provides mortgage credit insurance to low and moderate-income families on loans originated by the Housing Finance Authority and other financial institutions. This activity can be increased through legislative appropriations, if and when needed, and derives its revenue from premiums charged to the borrowers, interest on investments, and sales of properties acquired through foreclosure. The Housing Finance Authority manages the risk of loss of its mortgage loan insurance activities by providing its insurance program only to financial institutions that (1) maintain certain defined minimum capital, (2) are qualified based on experience and resources, (3) perform certain collection efforts, and (4) comply with established procedures and requirements. In addition, the Housing Finance Authority requires certain loan-to-value ratios on loans insured and recording of the collateral in the property registry of the Commonwealth.

Additionally, the Housing Finance Authority created the Puerto Rico Housing Administration program, expanding the requirements and parameters under the existing Act No. 87. The program allows citizens, paying an annual insurance premium, to originate mortgage loans with up to a 98% loan-to-value ratio. The program insures participating lending institutions in events of foreclosure. The program is financed through annual insurance premiums, commitment and transaction fees, and proceeds from any sale of foreclosed real estate. The program also requires participants to comply with various eligibility requirements.

The Commonwealth guarantees up to \$75 million of the principal insured by the mortgage loan insurance program. As of June 30, 2017, the mortgage loan insurance program covered loans aggregating to approximately \$571 million. A liability of \$8.8 million was recorded as of June 30, 2017, determined on the basis of the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the loan insurance guaranty.



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The mortgage insurance loan total premium and investment income for the year ended June 30, 2017, are as follows:

Mortgage loans insurance premiums	\$ 3,400,876
Investment income	<u>655,378</u>
Total	<u>\$ 4,056,254</u>

The regulations adopted by the Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the Mortgage Loan Insurance Fund. At June 30, 2017, the Housing Finance Authority had an unrestricted deficit for such purposes of approximately \$6.9 million.

**(15) Financial Instruments with Off-Balance-Sheet Risk**

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

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank, as applicable, evaluates each customer's creditworthiness on a case-by-case basis.

The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include property, plant, and equipment, and income-producing commercial properties. Standby letters of credit and financial guarantees are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

At June 30, 2017, the off-balance-sheet risks consisted of the following (in thousands):

Financial instruments whose credit risk is represented by contractual amounts:	
Financial guarantees – Private sector	\$ 284,903
Standby letters of credit – Public sector	\$ 1,286,481
Commitments to extend credit – Public sector	\$ 1,383,996
Commitments to extend credit (Housing Finance Authority) – Private sector	\$ 39,000

Although these guarantees and commitments have not been cancelled as of June 30, 2017, it is expected that none, except for the ones from Housing Finance Authority, Tourism Development Fund and Development Fund and some from the GDB Operating fund, will remain active, because in line with the Qualifying Modification discussed in Notes 4 and 22, the Bank will be winding down its operations and liquidating its assets and restructuring its liabilities no later than fiscal year 2019. These guarantees and commitments were terminated upon the closing of the Qualifying Modification.

Liabilities under guaranteed obligations are recognized in accordance with the provisions of GASB Statement 70 – *Accounting and Financial Reporting for Nonexchange Guarantees* ("GASB Statement 70"). GASB Statement 70 requires the recognition of a liability when qualitative factors and historical data, if any, indicates that it is more likely than not that the Bank or any of its blended component units, as guarantors, will actually be required to make payments as a result of the

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guaranty agreement to a third-party obligation holder. Such liability is recognized by using the best estimate of the discounted present value of the future outflows expected to be incurred as a result of the guarantee.

Following is the activity of the liability for guaranteed obligations for the year ended June 30, 2017:

	Beginning balance	Provision/ Increases	Payments/ Credits/Reductions	Ending balance	Due within one year
Tourism Development Fund	\$ 67,862,784	\$ 1,392,248	\$ (2,067,619)	\$ 67,187,413	\$ 19,000,000
Development Fund	1,993,108	-	(918,411)	1,074,697	-
GDB Operating Fund	113,929,000	6,445,000	-	120,374,000	-
<b>Total</b>	<b>\$ 183,784,892</b>	<b>\$ 7,837,248</b>	<b>\$ (2,986,030)</b>	<b>\$ 188,636,110</b>	<b>\$ 19,000,000</b>

***Government Development Bank (GDB Operating Fund)***

On September 22, 2011, Autopistas Metropolitanas de Puerto Rico, LLC (“Metropistas”) and HTA, entered into a concession agreement (the “Concession Agreement”) of toll roads PR-22 and PR-5 (the “Toll Roads”). In connection with this transaction, HTA received in exchange for the right to operate the Toll Roads a lump-sum payment of \$1.1 billion and a commitment to make immediate improvements to the Toll Roads amounting to \$56 million and to comply with world-class operating standards which may require HTA to invest more than \$600 million over the life of the concession.

In connection with the closing of the concession of the Toll Roads, the Bank executed a payment guarantee (the “Guaranty”) in favor of Metropistas pursuant to which it acts as guarantor of any “Termination Damages” due and payable in cash by the HTA under the Concession Agreement. In connection with the Guaranty, on September 22, 2011, the Bank and HTA entered into a Reimbursement Agreement (the “Reimbursement Agreement”) whereby the HTA agreed to reimburse the Bank any amounts paid under the Guaranty. Under the Reimbursement Agreement, in order to reimburse the Bank fully for any payments made under the Guaranty, HTA was required to issue bonds secured by the revenues generated by the Toll Roads within one year from the effective date of a termination of the Concession Agreement requiring the payment of Termination Damages. On September 22, 2011, HTA approved the bond resolution under which such bond issue would be authorized. Pending such bond issuances, the reimbursement obligation will be secured by the revenues of the Toll Roads generated after the termination of the Concession. No liability for this guaranteed obligation has been recognized as management has concluded that it is not more likely than not that the Bank will be required to make payments under this guaranty agreement.

On July 24, 2013, Aerostar Airport Holdings, LLC (“Aerostar”) and the Puerto Rico Ports Authority (the “Ports Authority”) entered into a lease agreement (the “Lease Agreement”) of Luis Muñoz Marín International Airport (the “Airport”), for a term of forty years. In connection with the lease of the Airport, the Bank executed a payment guarantee (the “Bank Guaranty”) in favor of Aerostar for any “Termination Damages” due and payable in cash by the Ports Authority under the Lease Agreement. In accordance with the Bank Guaranty, Aerostar has the right to terminate the Lease Agreement mainly under three different noncompliance scenarios on the part of the Ports Authority.

First, if Aerostar has the right to terminate this Agreement in connection with an “Adverse Action” or “AA”, as defined in the Lease Agreement, and Aerostar has exercised such right, the Lease Agreement, subject to certain conditions specified in the Lease Agreement, shall terminate 120 days following the date of receipt of the AA-Notice by the Ports Authority, and on the “Reversion Date” the Ports Authority shall pay an amount (which amount shall be paid from general Ports Authority’s funds and not from Airport revenues) equal to the aggregate, without duplication, of (i) the Airport “Facility Leasehold Value”, as defined, as of the date of termination (which shall be determined as if no Adverse Action has occurred), plus (ii) the reasonable out-of-pocket and documented costs and expenses incurred by Aerostar as a direct result of such termination, plus (iii) the “Leasehold Compensation” calculated for the period between the date of the Adverse Action and the Reversion Date, less (iv) any insurance or condemnation proceeds payable to Aerostar.

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Secondly, if termination relates to a default (a Default) on the part of the Ports Authority, that is, in accordance with Section 16.2 (b) (ii) or Section 16.2 (b) (iii) of the Lease Agreement, the Ports Authority shall be obligated to pay on the Reversion Date to Aerostar an amount (which amount shall be paid from general Ports Authority funds and not from Airport revenues) equal to the aggregate, without duplication, of (i) the Airport "Facility Leasehold Value" as of the date of termination, plus (ii) the reasonable out-of-pocket and documented costs and expenses incurred by Aerostar as a direct result of such termination, plus (iii) the "Leasehold Compensation" calculated for the period between the date of the Ports Authority's Default and the date of termination, less (iv) any insurance or condemnation proceeds payable to Aerostar.

Thirdly, and as general provision, the Lease Agreement may be rescinded in accordance with Section 16.6 of the Lease Agreement which relates to termination pursuant to conviction or the entering of a plea of guilty in respect to any Act No. 458 Crime. If the Lease Agreement is rescinded or terminated pursuant to Section 16.6 (a) or (b) and, in the case of a rescission caused by the conviction or the entering of a plea of guilty for an Act No. 458 Crime, such crime was not committed in connection with the procurement of the Lease Agreement, then the Ports Authority shall be obligated to pay to Aerostar an amount equal to the lesser of (i) the Airport "Facility Leasehold Value" and (ii) the "Unamortized Leasehold Fee". In connection with the Guaranty, on February 27, 2013, the Bank and the Ports Authority entered into a Reimbursement Agreement (the "Reimbursement Agreement") whereby the Ports Authority agreed to reimburse the Bank any amounts paid under the Bank Guaranty. No liability for this guaranteed obligation has been recognized as management has concluded that it is not more likely than not that the Bank will be required to make payments under this guaranty agreement as it related to the Lease Agreement.

The Bank had extended letters of credit to guarantee (along with the aforementioned reimbursement agreements), through a financing facility, the repayment of the PRIFA Bonds related to the Puerto Rico Ports Authority (PRIFA Revenue Bonds Series A, B, and C). The proceeds from the PRIFA Bonds had been used for the most part to repay and cancel certain loan obligations and swap agreements existing then at the Puerto Rico Ports Authority. The PRIFA Series A and C have already either been repaid by the Ports Authority or been honored by these letters of credits; and the portions honored by the Bank's letters of credits are already presented by the Bank as loans to Ports Authority, with their corresponding loan loss estimates already recognized within the allowance for loan losses discussed in note 8. Given the current financial situation of the Ports Authority, the Bank's management believes that it is more likely than not that the remaining PRIFA Bond Series B will be honored by the Bank's letter of credit guaranty. During fiscal year 2016, the Ports Authority made its last payment under the PRIFA Series B Bond repayment schedule, reducing the principal balance of such bonds by \$1.7 million. However, upon non-payment by the Ports Authority during fiscal year 2017 of the required debt service on the Series B bond, on May 17, 2017, the bonds' Trustee made a draw request under the Bank's corresponding letters of credit for approximately \$200 million on account of principal, interest and other related fees due on the bonds. No payments have been made to the Trustee through the date of these financial statements on the Series B bonds in respect of the amounts represented by the aforementioned draw amounts.

On September 10, 2018, the Bank, FAFAA and the Trustee entered into a settlement agreement whereas the Bank shall provide the Trustee, for the benefit of the Trustee and the Series B bondholders, an allowed Participating Bond Claim under the Qualifying Modification process described in Notes 3 and 22(c) in the amount of the draw request of approximately \$200 million plus interest on such amount at a rate of 3.75% accruing from the date of the draw request up to the eventual closing date of the Qualifying Modification. Upon the closing of the Qualifying Modification (on November 29, 2018), a Participating Bond Claim was provided to the Trustee pursuant to the settlement agreement and exchanged for New Bonds at the exchange rate of 55%. As a result of these developments, the best estimate of the discounted present value of the future outflows expected to be incurred on this guaranteed obligation has been determined to be approximately \$107.2 million at June 30, 2017, reflecting the expected effects of the aforementioned settlement agreement and the subsequent exchange for the New Bonds, at an estimated closing date near the first quarter of fiscal year 2019, in addition to the related effect of the time value of money when compared to prior year's calculation.

The Bank and the Commonwealth are parties to a Debt Service Deposit Agreement (DSDA) with Lehman Brothers (Lehman), dated as of June 6, 2005. The objective of the DSDA was for the Commonwealth to secure an upfront payment in exchange for granting Lehman the right to earnings generated from certain of the Commonwealth's debt service funds. Under the DSDA, the Commonwealth and, on a conditional basis, the Bank are exposed to the payment to Lehman of a termination amount (the "Termination Amount"), calculated pursuant to the terms of the DSDA and payable upon a breach

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of the DSDA or the occurrence of redemption or a defeasance of the related bonds on or prior to the last scheduled deposit date. The Termination Amount was expected to be approximately \$26,000,000. The Commonwealth and the GDB are jointly liable to Lehman for the Termination Amount, however, Lehman needed to first pursue remedies against the Commonwealth prior to pursuing remedies against the Bank and the Bank is not required to make any payment under the DSDA unless the Commonwealth has, among other things, repudiated the DSDA or raised a defense of immunity.

Upon the execution of the Qualifying Modification on November 29, 2018, the New Bonds issued did not initially cover the Lehman Termination Amount as a Participating Bond Claim; however, the Indenture Agreement established upon the Qualifying Modification provides for the potential of Additional Bonds to be issued in order to cover the Lehman Termination Amount and other exposures as Participating Bond Claims. The Bank's management believes it is more likely than not that the proposed termination agreement and the eventual exchange of such Participating Bonds Claim for Additional Bonds to be issued under the Qualifying Modification process will be executed. As a result of these developments, the best estimate of the discounted present value of the future outflows expected to be incurred on this guaranteed obligation has been determined to be approximately \$13.1 million at June 30, 2017, reflecting the expected effects of the aforementioned termination agreement and the subsequent exchange for the Additional Bonds, at an estimated closing date, in addition to the related effect of the time value of money when compared to prior year's calculation.

***Puerto Rico Development Fund***

On January 19, 2012, the Boards of Directors of the Bank and the Development Fund approved a loan guaranty program (the "Guaranty Program") to stimulate lending by private banks to businesses in Puerto Rico in order to promote job creation and economic development in Puerto Rico. On April 3, 2012, the Bank, the Development Fund and certain participating banks entered into guarantee and commitment and funding agreements in which the Development Fund will guarantee eligible loans made by those banks to eligible businesses up to a maximum of 30% of the principal amount of the loans, in accordance with criteria established in the Guaranty Program. The Bank had committed to provide up to \$200 million to the Development Fund to enable it to honor payments related to guarantees issued under the Guaranty Program. The Guaranty Program had a term of one year, and it ended on April 2, 2013. As of June 30, 2017, total loan balance under the Guaranty Program amounted to approximately \$30.5 million. The guarantee issued for each loan is in effect for a maximum term of seven years. The best estimate of the discounted present value of the future outflows expected to be incurred under the Development Fund's loan guaranty program has been determined to be approximately \$670,000 at June 30, 2017, reflecting a decrease during fiscal year 2017 of approximately \$878,000, mostly as a result of loans removed from the guaranty program by the corresponding private bank.

The Development Fund has entered into an agreement (the "Agreement") with EDB whereby the Development Fund would guarantee a portion of loans granted by EDB under a government program named The Key for Your Business (the "Business Program"). Under the Agreement, the Development Fund would assign \$15 million of its capital for the Business Program. The Development Fund guarantees one-third of the outstanding principal balance of each loan plus accrued interest and certain other charges. The Development Fund charges one percent of the loan amount as a guarantee fee and no loan can exceed \$50,000. As of June 30, 2017, the outstanding balance of these loans guaranteed by the Development Fund amounted to approximately \$704,000. The best estimate of the discounted present value of the future outflows expected to be incurred under the Development Fund's Key for Your Business Program has been determined to be approximately \$404,000 at June 30, 2017, reflecting a decrease of approximately \$40,000, mostly due to guaranty payments made during the year.

***Puerto Rico Tourism Development Fund***

The Tourism Development Fund was created in 1993 to promote the hotel and tourism industry of the Commonwealth, primarily through the issuance of letters of credit and guarantees. The Tourism Development Fund was also authorized to make capital investments and provide direct financing to tourism-related projects. As of June 30, 2017, the outstanding commitment amount under these guarantees amounted to approximately \$247.3 million. Since 2009, the Tourism Fund has been honoring various of its guarantees, upon which time such honoring payments are presented as loans from the Tourism Fund, with their corresponding loan loss estimates already recognized within the allowance for loan losses discussed in Note 8. Given the current financial situation and limited payment capacity of some of the underlying tourism

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projects, the Tourism Fund's management believes that it is more likely than not that most of these projects will be honored by the Tourism Fund's guaranty. The best estimate of the discounted present value of the future outflows expected to be incurred on these guaranteed obligations has been determined to be approximately \$67.2 million at June 30, 2017, reflecting a decrease of approximately \$675,000, mostly due to discounted settlement agreements reached subsequent to June 30, 2017 on several guarantees in exchange for the release of such claims, which were reflected in the estimations made as of June 30, 2017, slightly offset by the related effect of the time value of money when compared to prior year's calculation.

***Non-Appropriation of Funds for the Payment of Debt Service on PFC Bonds***

PFC, a component unit of the Bank, issued several series of bonds pursuant to a trust agreement between PFC and U.S. Bank National Association, as trustee (the "Trustee"), dated as of June 1, 2004 (the "Trust Agreement"), of which three series are outstanding (the "PFC Bonds"). The outstanding series are: (i) 2011 Series A Bonds – Act 164; (ii) 2011 Series B Bonds – Act 164 and PRASA Superaqueduct; and (iii) 2012 Series A Bonds – Act 164 Maritime. As of June 30, 2017, the outstanding balances of the PFC Bonds are approximately \$242.4 million, \$437.6 million, and \$410.7 million, respectively.

On July 1, 2015, Joint Resolution 63-2015 was enacted creating the Economic Development and Obligations Payment Fund (the "EDOP Fund"), to be funded with \$275 million from available resources. As of the date of the issuance of these financial statements, no moneys have been available to transfer to the EDOP Fund. Under the legislation, the utilization and distribution of the EDOP Fund requires a Joint Resolution of the Legislature. The EDOP Fund may only be used for economic development initiatives and for the payment of Commonwealth's obligations. On August 10, 2015, a resolution was filed in the Senate authorizing the transfer of \$93.7 million from the EDOP Fund to the Bank in order to pay the unpaid interest and principal which was due on the PFC Bonds on August 3, 2015. This resolution was not been approved by the Legislature. On July 15, 2015, the PFC filed a notice with the Municipal Securities Rulemaking Board ("EMMA") indicating that the Puerto Rico Legislative Assembly had not included in the approved budget for fiscal year 2016 the funds necessary to pay principal and interest on all outstanding PFC bonds. Such appropriation is the sole source of payment of principal and interest on such bonds. The EMMA notice indicated that the Office of Management and Budget had included the necessary appropriation for the payment of such debt service, but such appropriation was not included in the budget that the Legislature ultimately approved and sent to the Governor for approval. As a result, except as indicated below, the Trustee for such PFC bonds did not receive the funds from fiscal year 2016 legislative appropriations to pay the debt service due during fiscal year 2016. The first payment of the debt service for fiscal year 2016 was due on August 3, 2015. On August 3, 2015, the PFC made a partial payment of interest in the amount of \$628,000 from funds held by the Public Finance Corporation representing funds remaining from prior legislative appropriations. On August 10, 2015, a resolution was introduced in the Legislative Assembly authorizing the payment of past due amounts to the PFC bondholders. However, this resolution was not been approved, and no legislative appropriation has been made to pay principal and interest on outstanding PFC bonds during fiscal year 2016. For fiscal years 2017 and 2018, no amounts have been included in the Commonwealth General Fund budget for the payment of any debt, including the PFC bonds; hence, the introduction of a resolution authorizing a payment to the PFC bondholders was neither made nor necessary.

The PFC bonds provides for a Bank Letter of Credit (each PFC Bond). As per the terms of such Letters of Credit and the Trust Agreement, the Trustee may draw up to the "stated amount" for each fiscal year in the event that the Trustee (a) has not received a timely notice by the President of PFC that the budget for the current fiscal year has been adopted by the Legislature and approved by the Governor of Puerto Rico, and (b) has not otherwise received the funds equal to the principal and interest payable on the PFC bonds for the current fiscal year. The yearly "stated amount" is intended to cover the differential between an increase in debt service under the PFC bonds for such year and the amount of appropriated funds for the previous year. The "stated amount" for fiscal year 2016 varies for each of the Bank's Letters of Credit, as follows: (a) for the Series 2011 A Bonds, \$0; (b) for the Series 2011 B Bonds, \$20.2 million; and (c) for the Series 2012 A Bonds, \$0.

Based on legal counsel opinion, the Bank complied with the requirements of the Trust Agreement and duly notified the Trustee that the budget was approved and thus the conditions to draw the Bank's Letters of Credit to make the payment did not ensue. Accordingly, the Bank did not recognize any contingent liability related to this non-appropriation as of June 30, 2017.

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**(16) Retirement System**

**(a) *Structure of Retirement System and Accounting for Pension Costs***

ERS is a trust created by the Legislature under Act No. 447 of May 15, 1951 (as amended, Act No. 447) to provide pension and other benefits to retired employees of the Commonwealth, its public corporations (including the Bank) and municipalities. Before the enactment of Act No. 106-2017 on August 23, 2017, ERS administered different benefit structures under Act No. 447, as amended, including a cost-sharing, multiple-employer, defined benefit program, a defined contribution program (System 2000 Program) and a contributory hybrid program. Benefit provisions varied depending on each member's date of hire. Substantially all full-time employees of the Commonwealth and its instrumentalities (73 Commonwealth agencies, 78 municipalities, and 55 public corporations, including the Bank) were covered by the ERS under Act No. 447. Membership was mandatory for all regular, appointed, and temporary employees of the Commonwealth at the date of employment. Membership was optional for the Governor of the Commonwealth, Commonwealth secretaries, head of public agencies and instrumentalities, among others.

The benefits provided to members of ERS were established by Commonwealth law and may only be amended by the Legislature with the Governor's approval. Act No. 3 of April 3, 2013 (Act No. 3), in conjunction with other recent funding and design changes, provided for a comprehensive reform of ERS. This summary details the provisions under Act No. 3 which were in effect prior to August 23, 2017.

Certain provisions of Act No. 3 were different for the three groups of members who entered the ERS before July 1, 2013, as described below:

- Members of Act No. 447 were generally those members hired before April 1, 1990.
- Members of Act No. 1 of February 16, 1990 (Act No. 1) were generally those members hired on or after April 1, 1990 and on or before December 31, 1999.
- Members of Act No. 305 of September 24, 1999 (Act No. 305) were generally those members hired on or after January 1, 2000 and on or before June 30, 2013.

All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit program and the System 2000 program, and were rehired on or after July 1, 2013, became members of a newly established defined contribution program similar to the System 2000 Program (the Contributory Hybrid Program) as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous programs became part of the Contributory Hybrid Program on July 1, 2013.

The assets of the defined benefit program, the defined contribution program and the Contributory Hybrid Program were pooled and invested by ERS. Future benefit payments were to be paid from the same pool of assets. However, upon the enactment of Act 106-2017 on August 23, 2017, most of the System's assets were sold and transferred to the General Fund and the plans described under Act No. 3 were frozen.

This summary of ERS's pension plan provisions is intended to describe the essential features of the plan before the enactment of Act 106-2017. All eligibility requirements and benefit amounts were determined in strict accordance with the plan document itself.

***Cost-Sharing, Multiple-Employer, Defined Benefit Program***

Pursuant to Act No. 447, all regular employees of the Bank hired before January 1, 2000 and less than 55 years of age at the date of employment became members of the ERS, under the Defined Benefit Program, as a condition of their employment. No benefits were payable if the participant received a refund of their accumulated contributions.

The Defined Benefit Program provides retirement, death, and disability benefits pursuant to legislation enacted by the Legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits

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vest after 10 years of plan participation. Disability benefits were available to members for occupational and non-occupational disabilities. However, a member must have at least 10 years of service to receive non-occupational disability benefits.

Members who had attained 55 years of age and have completed at least 25 years of creditable service, or members who had attained 58 years of age and have completed 10 years of creditable service, were entitled to an annual benefit payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. The annuity for which the participant was eligible, was limited to a minimum of \$500 per month and a maximum of 75% of the average compensation, as defined.

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

The contribution requirement to ERS was determined by law and not actuarially determined. Commonwealth legislation required employees to contribute 5.775% of the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Bank was required by the same statute to contribute 9.275% of each participant's gross salary. Pursuant to Act No. 116 of July 16, 2011, the Bank's contribution was increased to 10.275% for 2012, an additional 1% annually (15.275% for 2017) for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% that would have been effective July 1, 2020.

Act No. 1 of February 16, 1990, made certain amendments applicable to new participating employees joining the ERS effective April 1, 1990. These changes consisted principally of an increase in the retirement age from 55 to 65, a decrease in the benefit percentage of the average compensation in the occupational disability and occupational death benefits annuities from 50% to 40%, and the elimination of the Merit Annuity for participating employees who completed 30 years of creditable service.

On September 24, 1999, the Legislature enacted Act No. 305, which amended Act No. 447 to establish a new retirement program. In addition, on April 4, 2013, the Legislature enacted Act No. 3, which amended the provisions of the different benefit structures under ERS, including the Defined Benefit Program.

***Defined Contribution Program-System 2000 Program***

The Legislature enacted Act No. 305 on September 24, 1999, which amended Act No. 447 to create, among other things the System 2000 Program, a new benefit structure, similar to a cash balance plan (Defined Contribution Plan). All regular employees hired for the first time on or after January 1, 2000, and former employees who participated in the Defined Benefit Program, received a refund of their contributions, and were rehired on or after January 1, 2000, and became members of the System 2000 Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the Defined Benefit Program had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the Defined Benefit Program plus interest thereon to the System 2000 Program.

Act No. 305 required employees to contribute 8.275% of their monthly gross salary to the System 2000 Program. Employees had the option to elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to individual accounts established under the Systems 2000 Program. Participants had three options to invest their contributions to the System 2000 Program. Investment income was credited to the participant's account semiannually.

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The Bank was required by the same statute to contribute 9.275% of each participant's gross salary. Pursuant to Act No. 116 of July 16, 2011, the Bank's contribution was increased to 10.275% for 2012, an additional 1% annually (15.275% for 2017) for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020.

Under the System 2000 Program, contributions received from participants were pooled and invested by ERS, together with the assets corresponding to the Defined Benefit Program. Future benefit payments under the Defined Benefit Program and the System 2000 Program were to be paid from the same pool of assets. As a different benefit structure, the System 2000 Program was not a separate plan and the Commonwealth does not guarantee benefits at retirement age. Corresponding employers' contributions were to be used by ERS to reduce the unfunded status of the Defined Benefit Program.

The System 2000 Program reduced the retirement age from 65 years to 60 years for those employees who joined this plan on or after January 1, 2000.

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

As discussed further below, on April 4, 2013, the Legislature enacted Act No. 3, which further amended the provisions of the different benefit structures under ERS, including the System 2000 Program and the Defined Benefit Program.

***Defined Contribution Hybrid Program***

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447 and Act No. 305 to establish, among other things the Contributory Hybrid Program to be administered by ERS. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit pension plan and the Defined Contribution Plan, and were rehired on or after July 1, 2013, became members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous plans became part of the Contributory Hybrid Program.

Participants in the Defined Benefit Program, who as of June 30, 2013, were entitled to retire and receive some type of pension, could retire on any later date and would receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Contributory Hybrid Program. Participants who as of June 30, 2013, had not reached the age of 58 and completed 10 years of service or had not reached the age of 55 and completed 25 years of service could retire depending on the new age limits defined by the Contributory Hybrid Program and would receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Contributory Hybrid Program.

Participants in the Defined Contribution Plan who as of June 30, 2013, were entitled to retire because they were 60 years of age could retire on any later date and would receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Contributory Hybrid Program. Participants who as of June 30, 2013, had not reach the age of 60 could retire depending on the new age limits defined by the Contributory Hybrid Program and would receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Contributory Hybrid Program.

Act. No. 3 required employees to contribute ten percent (10%) of their monthly gross salary to the Contributory Hybrid Program. Employee contributions were to be credited to individual accounts established under the Contributory Hybrid Program. In addition, a mandatory contribution equal to or less than point twenty five percent (0.25%) was required for the purchase of disability insurance.



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The Bank was required to contribute 16.525% of each participant’s gross salary for fiscal year 2017. ERS would use these contributions to increase its level of assets and to reduce the actuarial deficit. Beginning on July 1, 2013, and up until June 30, 2016, the employer’s contribution rate was annually increased by one percent (1%). Beginning July 1, 2016, and up until June 30, 2021, the employer’s contribution rate that was in effect on June 30 of every year was to be annually increased on every successive July 1st by one and one-quarter point percent (1.25%).

Upon retirement, the balance in each participant’s account would be used to purchase an annuity contract, which would provide for a monthly benefit during the participant’s life. In case of the pensioner’s death the designated beneficiaries would continue receiving the monthly benefit until the contributions of the participant were completely consumed. In case of the participants in active service a death benefit would be paid in one lump sum in cash to the participant’s beneficiaries. Participants with a balance of less than \$10,000 or less than five years of computed services at retirement would receive a lump-sum payment. In case of permanent disability, the participants have the option of receiving a lump sum or purchasing an annuity contract.

To improve the liquidity and solvency of ERS, the Commonwealth enacted Act No. 32 of June 25, 2013, which provided for incremental annual contributions from the Commonwealth General Fund beginning in fiscal year 2014 and up to fiscal year 2033. This additional uniform contribution was to be determined annually based on actuarial studies to be performed by ERS actuaries. Pursuant to the Treasury Department Circular Letter No. 1300-46-17 issued on June 27, 2017, the additional uniform contribution was eliminated as of the start of fiscal year 2018 on July 1, 2017.

Total employee contributions for the different retirement programs during the year ended June 30, 2017, were approximately \$1,486,000. The Bank’s contributions during the year ended June 30, 2017 corresponding to such active employees, was approximately \$2,307,000. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the ERS itself.

***Net Pension Liability of the ERS***

The total pension liability as of June 30, 2016 (the measurement date used for financial reporting for fiscal year 2017) was determined by an actuarial valuation as of July 1, 2015 that was rolled forward to June 30, 2016 and assuming no gains or losses.

**(1) Actuarial Methods and Assumptions**

The actuarial valuation used the following actuarial methods and assumptions, applied to all periods in the measurement:

Actuarial cost method	Entry age normal
Asset-valuation method	Market value of assets
Actuarial assumptions:	
Inflation rate	2.5%.
Salary increases	3.0% per year. No compensation increases are assumed until July 1, 2021 as a result of Act No.66 and the current general economy

The mortality tables used in the actuarial valuations were as follows:

- Pre-retirement Mortality- For ERS general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year, and projected forward using MP-2016 on generational basis. For the ERS general employees covered under Act No. 127, RP-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year, and projected forward using MP-2016 on generational basis. As generation tables, they reflect mortality improvements both before and

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after the measurement date. 100% of deaths while in active service are assumed to be occupational only for members covered under Act No. 127.

- Post-retirement Healthy Mortality- Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projected using Mortality Improvement Scale MP-16 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.
- Post-retirement Disabled Mortality- Rates which vary by gender are assumed for disabled retirees based on a study of Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-16 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

Most other demographic assumptions used in the July 1, 2014 valuation were based on the results of actual experience study using data as of June 30, 2003, June 30, 2005 and June 30, 2007.

Actuarial assumptions are revised periodically to more closely reflect actual, as well as anticipated future experience. Due to the change in the census collection date to the beginning of the fiscal year, rather than the end of the fiscal year, demographic gain/loss during the year is limited to the difference between actual and expected benefit payments, which arise from differences in termination and retirement activity and mortality versus expectations.

(2) *Long-term Rate of Return on Investments*

The long-term expected rate of return on pension benefits investments was determined in accordance with the asset allocation of the portfolio that was adopted by ERS board during December 2013 and the actuary's capital market assumptions as of June 30, 2016. In addition, the assumption reflects that loans to members comprise approximately 50% of the portfolio and have an approximate return of 9.1% with no volatility. The long-term expected rate of return on pension benefits investments of 6.55% as of June 30, 2016 is equal to the highest debt service of the senior pension funding bonds payable which range from 5.85% per annum to 6.55% per year.

The pension plans' policy in regard to allocation of invested assets is established and may be amended by ERS Board. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on ERS financial condition for the benefits provided through the pension programs. The following was the ERS Board's adopted asset allocation policies as of June 30, 2016:

	<u>Target allocation</u>	<u>Long-term expected rate of return</u>
Asset class:		
Domestic equity	25%	6.4%
International equity	10	6.7
Fixed income	64	6.3
Cash	1	3.0
	<hr/>	
Total	<u>100%</u>	

The long-term expected rate of return on pension benefits investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term

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expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

(3) *Discount Rate*

The asset basis for the date of depletion projection is the ERS' fiduciary net position (the gross assets plus deferred outflows of resources less the gross liabilities, including the senior pension funding bonds payable, less deferred inflows of resources). On this basis, the ERS fiduciary net position became negative in the fiscal year 2015 and accordingly no projection of date of depletion is needed.

The ERS fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the tax free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability.

The discount rate used to measure the total pension liability was 2.85% as of June 30, 2016.

The date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No.32 because of actual fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth and the municipalities, and in the event that their financial condition does improve in the near term.

***The Bank's Proportion of Net Pension Liability of ERS***

The following table presents the Bank's proportionate share of the net pension liability of the ERS at June 30, 2016 (the measurement date), and the proportion percentage of the aggregate net pension liability of the ERS allocated to the Commonwealth:

	<u>GDB Operating Fund</u>	<u>Housing Finance Authority</u>	<u>Total for the Bank</u>
The corresponding entity's proportion of the net pension liability	0.38252%	0.15693%	0.53945%
The corresponding entity's proportionate share of the net pension liability	\$ 144,206,599	59,160,168	203,366,767

The Bank's proportion of ERS's net pension liability was based on the actual required contributions of each of the participating employers that reflect each employer's projected long-term contribution effort. The contributions that reflect each employer's projected long-term contribution effort included in the proportionate share calculation are: 1) Act No. 116 of 2010 statutory payroll-based contribution, 2) Act No. 3 of 2013 supplemental contribution, and 3) other special law contributions. Contributions to ERS of approximately \$6.9 million were made as of the measurement date. Other contributions to ERS that do not reflect an employer's projected long-term contribution effort, such as contributions that separately finance specific liabilities of an individual employer to ERS (i.e. local employer early retirement incentives), are excluded from the proportionate share calculation.

In addition, Act No. 32 of 2013 Additional Uniform Contribution (AUC), which is a contribution that reflects each employer's projected long-term contribution effort, was excluded from the proportionate share calculation because its collectability from various employers, including the Commonwealth, is uncertain at this moment. This prevents an overallocation of GASB Statement No. 68 amounts to the employers who have paid their AUC (or are expected to do so) and an underallocation of GASB Statement No. 68 amounts to the employers who have not paid their AUC (or are not expected to do so).

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The following table presents the Bank's proportionate share of the net pension liability for ERS calculated using the discount rate of 2.85%, as well as what the Bank's proportionate share of the net pension liability would be if it were calculated using a discount rate of 1%-point lower (1.85%) or 1% percentage-point higher (3.85%) than the current rate:

	<u>1% decrease or 1.85%</u>	<u>Current discount rate of 2.85%</u>	<u>1% increase or 3.85%</u>
GDB Operating Fund's proportionate share of the net pension liability	\$ 165,399,272	144,206,599	126,951,470
Housing Finance Authority's proportionate share of the net pension liability	<u>67,854,375</u>	<u>59,160,168</u>	<u>52,081,322</u>
Total Bank	<u>\$ 233,253,647</u>	<u>203,366,767</u>	<u>179,032,792</u>

***Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources from Pension Activities***

Pension expense recognized by the Bank for the year ended June 30, 2017 related to ERS amounted to \$20,729,540.

Deferred outflows and deferred inflows of resources from pension activities by source reported by the Bank in the statement of net position (deficit) at June 30, 2017 are as follows:

<u>Source</u>	<u>GDB Operating Fund</u>	
	<u>Deferred outflows of resources</u>	<u>Deferred inflows of resources</u>
Differences between expected and actual experience	\$ 117,900	1,979,729
Changes in assumptions	21,995,955	—
Net difference between projected and actual earnings on pension plan investments	—	780,279
Changes in proportion and differences between actual contributions and proportionate share	12,576,213	—
Employer contributions made subsequent to the measurement date	<u>4,610,322</u>	<u>—</u>
Total	<u>\$ 39,300,390</u>	<u>2,760,008</u>

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Source	<b>Housing Finance Authority</b>	
	<b>Deferred outflows of resources</b>	<b>Deferred inflows of resources</b>
Differences between expected and actual experience	\$ 48,368	812,176
Changes in assumptions	9,023,751	—
Net difference between projected and actual earnings on pension plan investments	—	320,106
Changes in proportion and differences between actual contributions and proportionate share	789,164	—
Employer contributions made subsequent to the measurement date	2,242,751	—
Total	<u>\$ 12,104,034</u>	<u>1,132,282</u>

Source	<b>Total Business-Type Activities</b>	
	<b>Deferred outflows of resources</b>	<b>Deferred inflows of resources</b>
Differences between expected and actual experience	\$ 166,268	2,791,905
Changes in assumptions	31,019,706	—
Net difference between projected and actual earnings on pension plan investments	—	1,100,385
Changes in proportion and differences between actual contributions and proportionate share	13,365,377	—
Employer contributions made subsequent to the measurement date	6,853,073	—
Total	<u>\$ 51,404,424</u>	<u>3,892,290</u>

Amounts reported as deferred outflows/inflows of resources from pension activities at June 30, 2017 will be recognized in the pension expense as follows:

	<b>GDB Operating Fund</b>	<b>Housing Finance Authority</b>	<b>Total Bank</b>
Year ending June 30:			
2018	\$ 6,865,395	1,876,853	8,742,248
2019	6,865,395	1,876,853	8,742,248
2020	7,165,834	1,958,987	9,124,821
2021	7,242,951	1,980,069	9,223,020
2022	3,790,486	1,036,238	4,826,724
Total	<u>\$ 31,930,060</u>	<u>8,729,001</u>	<u>40,659,061</u>

Deferred outflows of resources related to pensions resulting from the Bank's contributions subsequent to the measurement date which amounted to \$6,853,073 as of June 30, 2017 (\$4,610,322 from the GDB Operating Fund and \$2,242,751 from the Housing Finance Authority), will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. This amount is not included in the table above.

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Additional information on the ERS is provided in its standalone financial statements for the year ended June 30, 2016, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico, P.O. Box 42004, San Juan PR 00940-2004.

**(b) *Early Retirement Programs***

During the year ended June 30, 2017, the Bank extended to its employees a new voluntary early retirement program. This program was approved by the Bank's Board of Directors based on provisions established on Act No. 211, which was enacted December 8, 2015. Act No. 211 provides that eligible employees may retire from employment with the Bank in exchange for an early pension and other benefits. Act No. 211 only applied to employees with twenty years or more participating in the ERS created pursuant to Act No. 447 of 1951 and that have not reached 61 years of age.

The Act No. 211 provides that the employee will receive an annuity equivalent to 60% of the average compensation, as defined, as of December 31, 2015 and until the participating member attained 61 years old, which is the age the employee will become part of the ERS. The Bank is responsible for the payment of the employer contribution to the Social Security and Medicare, based on the 60% of the average compensation as of December 31, 2015. The Bank is also responsible for the payment of the related employee and employer contributions to the ERS based on the 100% of average salary as of December 31, 2015, for amounts which guarantees a 50% minimum compensation to eligible employee of its average compensation as of June 30, 2013. The participating employee will also receive the benefits of health insurance for a period not more than two years, and until he or she reaches 61 years old.

From fiscal year 2011 through fiscal year 2013 the Bank extended to its employees voluntary early retirement programs, based on provisions established on Act. No. 70 which was enacted July 2, 2010. Act No. 70 provided that eligible employees may retire from employment with the Commonwealth in exchange for an early pension, an economic incentive and other benefits. Act. No. 70 only applied to employees who were fifteen years or less from retirement in accordance with their applicable retirement plans. The number of employees who have voluntarily separated from employment under the provisions of Act No. 70 were twenty-one. Payments of such voluntary termination plans are expected to be made until November 1, 2030. Employee and employer contributions to the Retirement System and the employee annuity for the applicable period were discounted based on the average interest rate of return of unpledged investments.

In addition, during the fiscal years 1995, 2000 and 2007, the Bank's Board of Directors authorized early retirement's programs for certain Bank's employees, subject to different eligibility provisions that are detailed in the corresponding laws signed by the Governor of the Commonwealth. The costs incurred and accounted during the year ended June 30, 2017, consisted principally of the incremental actuarial costs, if any, of retiring earlier than under the original retirement plan to cover the costs of the medical and life insurance plans for such employees until reaching certain age. As of June 30, 2017, the number of employees still benefiting from such voluntarily separation programs are approximately 210. Employer contributions to the medical and life insurance plans for the applicable period were discounted based on management best estimate of the expected long-term plan performance.

During fiscal year 2017, total cost related to these early termination benefits amounted to approximately \$7.2 million, mostly related to the early retirement program under Act No. 211, which, as explained above, became effective for the first time during fiscal year 2017. As of June 30, 2017, the total liability related to these termination benefits was approximately \$14.9 million, recorded within accounts payable and accrued liabilities in the GDB Operating Fund.

**(17) Risk Management**

To minimize the risk of loss, the Bank purchases insurance coverage for public liability, hazard, automobile, crime, and bonding as well as workmen's compensation insurance for employees. The selection of the insurer has to be approved by the Public Insurance Office of the Department of the Treasury of the Commonwealth. Insurance coverage is updated annually to account for changes in operating risk. For the last three years, insurance settlements have not exceeded the amount of coverage.

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**(18) Commitments and Contingencies**

**(a) Lease Commitments**

The Bank leases office space in what is known as “Minillas” from the governmental sector. Principally, office space is leased under an operating lease agreement that expires on July 1, 2039. During fiscal year 2010, the Bank entered into a lease agreement with the Puerto Rico Industrial Development Company (“PRIDCO”) for office space in PRIDCO’s New York Office. This agreement expires in 2022.

The Housing Finance Authority entered into a 30-year lease agreement with the Department of Housing to rent office space expiring in 2037. During the term of the lease, the Housing Finance Authority will pay an annual rent of \$1.5 million. The agreed upon rent includes parking spaces, maintenance and security services in common areas. The Department of Housing is responsible for the payment of utilities in exchange for an additional payment of \$350,000 payable in a lump sum on or before August 31st of each year.

Rent charged to operations in fiscal year 2017 amounted to approximately \$3.0 million. At June 30, 2017, the minimum annual future rentals under noncancelable leases are approximately as follows:

Year ending June 30:	
2018	\$ 2,665,000
2019	2,669,000
2020	2,673,000
2021	2,673,000
2022	2,673,000
Thereafter	<u>41,379,000</u>
Total	<u>\$ 54,732,000</u>

Although the Bank’s lease agreements for its space in Minillas and New York have not been amended as of June 30, 2017, it is expected that neither will last until its expiration date. It is expected that the related lease agreements will be amended to change the name of the lessees to the name of other governmental tenants. Therefore, the annual future rentals under these lease agreements is expected to differ from the ones presented in the table referred to above.

**(b) Cooperative Development Investment Fund**

On August 18, 2002, the Legislature approved Act No. 198, which creates the Cooperative Development Investment Fund (the “Cooperative Fund”). The purpose of the Cooperative Fund is to promote the development of cooperative entities. The Cooperative Fund will be capitalized through contributions to be provided by the Bank up to \$25 million to be matched by cooperative entities. As of June 30, 2017, the Bank has contributed \$24.6 million, including interest to the Cooperative Fund, \$1.2 million of which was contributed during the year ended June 30, 2017.

**(c) Other Risks Related to Mortgage Loans Servicing and Insurance Activities**

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

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(d) *Mortgage Loan Servicing Activities*

The Housing Finance Authority acts as servicer for a number of mortgage loans owned by other investors. The servicing is generally subcontracted to a third party. As of June 30, 2017, the principal balance of the mortgage loans serviced for others is approximately as follows:

Puerto Rico Community Development Fund I	\$ 29,301,500
CRUV or its successor without guaranteed mortgage loan payments	<u>19,113</u>
Total	<u>\$ 29,320,613</u>

(e) *Litigation*

The Bank and certain of its component units are defendants in several lawsuits arising out of the normal course of business. Management, based on advice of legal counsel, is of the opinion that the ultimate liability, if any, resulting from these pending proceedings will not have a material adverse effect on the financial position and results of operations of the Bank or its component units.

On December 2, 2014 and on January 16, 2015, the United States Securities and Exchange Commission (SEC) requested information about certain bond issuances of the Commonwealth and its component units. The Commonwealth and the Bank have been cooperating in the inquiry, including providing the SEC with documents and information. The SEC has advised that the information requests should not be construed as an indication that any violation of the federal securities laws has occurred. In April 2018, the SEC communicated that they do not intend to recommend an enforcement action against the Commonwealth.

*Brigade Leveraged Capital Structures Fund Ltd. v. Garcia Padilla*, Case No. 16-1610-FAB (D.P.R. Apr. 4, 2016). The holder of a substantial amount of bonds issued by GDB filed a complaint seeking a declaration that the Moratorium Act, and executive orders issued pursuant to the Act, violate the United States and Commonwealth's Constitutions, and alleging that the Moratorium Act (i) rewrites the contractual and legal rights and entitlements of GDB's creditors; (ii) takes, without due process or just compensation, property to which GDB's creditors are entitled for the benefit of the Commonwealth, other Puerto Rico government entities, and their respective creditors; (iii) facially discriminates against interstate commerce by providing for preferential treatment of Puerto Rico resident institutional holders of GDB bonds over nonresident holders of GDB bonds of equal rank; (iv) establishes a law on bankruptcy within the power of the United States Congress and preempted by Congress's exercise of those powers; and (v) unconstitutionally seeks to preclude creditors of GDB from suing in federal court. On August 1, 2017, the District Court dismissed the case with prejudice.

*Trigo Gonzalez v. Garcia Padilla*, Case No. 16-2257-FAB (D.P.R. June. 30, 2016). On June 30, 2016, a group of Puerto Rico residents who own bonds issued by either GDB or PFC filed a complaint challenging the Moratorium Act on constitutional grounds, alleging that it (i) usurps the powers vested by Congress to the Bankruptcy Court and contained in the Bankruptcy Code" (ii) is preempted by the Bankruptcy Code; and (iii) impairs creditors' rights without consent and gives preference to one creditor over another in violation of plaintiffs' rights under the Contract Clause; and (iv) deprives plaintiffs of their proprietary right to existing and future funding for the repayment of their bonds in violation of the Takings Clause. The complaint sought a declaratory judgment that certain sections of the Moratorium Act, and any executive or governmental action predicated on those sections, are null and void. On May 18, 2017, the District Court dismissed the case with prejudice.

On July 7, 2016, defendants filed a motion to stay the action. On August 22, 2016, the District Court granted defendants' motion to stay. On November 11, 2016, the District Court denied plaintiffs' motion to lift the stay and the Oversight Board's motion to intervene. On May 17, 2017, the Puerto Rico Department of Justice filed a notice of stay under Title III of PROMESA. The District Court entered an order confirming the stay the same day. On May 18, 2017, the District Court dismissed the case without prejudice pursuant to a notice of voluntary dismissal. This matter is now concluded.



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On July 8, 2016, defendants filed a motion to stay the action, which the District Court granted on August 22, 2016. On November 15, 2016, the District Court denied plaintiffs' motion to vacate the stay, as well as the Oversight Board's motion to intervene. On January 11, 2017, the United States Court of Appeals for the First Circuit affirmed the District Court's decision and remanded for further proceedings. On May 16, 2017, the Puerto Rico Department of Justice filed a notice of stay under Title III of PROMESA. On May 17, 2017, the District Court entered an order confirming the stay. On August 1, 2017, the District Court dismissed the case with prejudice. On August 29, 2017, plaintiffs filed an informative motion objecting to the dismissal order. There has been no further docket activity.

*FOMB Investigation and Claims Objections.* On September 13, 2017 the Oversight Board announced that a Special Investigation Committee has retained an independent investigator to carry out a review of the Commonwealth's debt (including the Bank's debt) and its connection to the current financial crisis. The Special Committee considers this investigation an integral part of the Oversight Board's mission to restore fiscal balance and economic opportunity and to promote the Commonwealth's reentry to the capital markets. The independent investigator's work concluded, and the Oversight Board published the independent investigator's final report on August 20, 2018 (the Debt Investigation Report). The Debt Investigation Report provides an analysis of the historical and more recent macroeconomic and political factors contributing directly and indirectly to the Commonwealth's fiscal and economic crisis, the Commonwealth's municipal bond issuance process, and legislative efforts to restructure the debt, as well as the Oversight's Board investigative findings, policy recommendations, and identification of potential claims and matters for regulatory attention.

The Debt Investigation Report presented findings and recommendations on the following areas:

- GDB
- Puerto Rico Public Utilities (PREPA and PRASA)
- Puerto Rico Sales Tax Financing Corporation (COFINA)
- ERS
- Puerto Rico's Budgeting, External Reporting, and Accounting Functions
- Calculation of the Constitutional Debt Limit
- Credit Rating Agencies (CRAs)
- Selling Practices for Puerto Rico-Related Bonds
- Puerto Rico's Government Ethics Framework
- Issuers' Use of Interest Rate Swaps
- Puerto Rico's Lack of a Clear Mechanism for Validating Puerto Rico-Related Bonds Before They Issue
- Possession Tax Credit

Finally, the independent investigator presented an overview of potential causes of action. The Debt Investigation Report in its entirety can be found on the Oversight Board's website.

On August 28, 2018, the Oversight Board appointed its Special Claims Committee (the "Special Claims Committee") and delegated to the Special Claims Committee any and all authority of the Oversight Board to review the findings in the Debt Investigation Report and to take any appropriate steps, including, but not limited to, recommending and/or initiating the negotiation and/or prosecution of claims based on the findings in the Debt Investigation Report on behalf of the Title III debtors for the benefit of all creditors and parties in interest in the Title III cases. The Special Claims Committee is entitled, in its full discretion, to determine the scope of any further action, including, but not limited to, additional investigation, as well as claims to be pursued, and to retain such advisors, consultants, attorneys or other advisors as it in its sole discretion sees fit. On October 25, 2018, the Oversight Board requested proposals for counsel to assist the Special Claims Committee regarding consideration of potential claims described in the Debt Investigation Report. On November 28, 2018, the Special Claims Committee signed the contract with the firm that will provide those services. The Bank is cooperating with this investigation.

On January 14, 2019, the Special Claims Committee, on behalf of the Oversight Board, and the Creditors' Committee filed a joint omnibus objection (the GO Claims Objection) seeking the disallowance of more than \$6 billion of claims related to the Commonwealth's GO bonds issued on or after March 2012, including (a) \$2.3 billion in Public Improvement Refunding Bonds, Series 2012 A issued in April 2012; (b) \$415.27 million in Public Improvement

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Refunding Bonds, Series 2012 B issued in March 2012; and (c) \$3.5 billion in General Obligation Bonds of 2014, Series A issued in March 2014 (collectively, the Challenged GO Bonds). According to the GO Claims Objection, the Challenged GO Bonds are “invalid” because, among other things, they were issued in violation of: (i) the Commonwealth Constitution’s debt service limit, which should have included debt service on bonds issued by the PBA that the GO Claims Objection characterizes as a “sham” structure; (ii) the Commonwealth’s constitutional balanced budget clause, which should have included \$425 million of interest that was excluded; and (iii) the Commonwealth’s constitutional balanced budget clause because proceeds of the Challenged GO Bonds were used to finance deficit spending. On February 15, 2019, the Title III Court entered a procedures order related to the GO Claims Objection, which gives parties until April 16, 2019 to provide notice of their participation in the proceedings related to the GO Claims Objection. On April 22, 2019, the Special Claims Committee filed an informative motion notifying the Title III Court of all parties who provided notice of their participation. This participation list was last updated by an informative motion filed on July 23, 2019. On July 24, 2019, the Title III Court entered an order staying several complex litigations in the Title III cases, including the GO Claims Objection, until November 30, 2019 and mandating mediation to resolve overlapping issues. By order entered on October 28, 2019, the Title III Court extended its stay order until December 31, 2019.

Between April 30, 2019 and May 20, 2019, the Special Claims Committee and the Creditors’ Committee filed 272 separate avoidance actions seeking to avoid and recover certain transfers made by the Commonwealth to its creditors prior to the Commonwealth’s Title III petition date. Of these avoidance actions, approximately 254 actions seek to recover funds from the Commonwealth’s vendors (collectively, the Vendor Avoidance Actions). On July 12, 2019, the Title III Court entered an order establishing litigation procedures for the Vendor Avoidance Actions. Under these procedures, all defendants may participate in a voluntary information exchange and negotiate with the Special Claims Committee to resolve their respective Vendor Avoidance Actions consensually prior to litigation. If negotiations fail or a defendant elects not to participate in the information exchange, all such defendants must respond to the complaint in their respective Vendor Avoidance Actions by no later than January 13, 2020.

On February 10, 2020, the court appointed mediation team filed an amended report and recommendation, providing the Title III Court with revised scheduling recommendations. On March 10, 2020, the Title III Court largely adopted the amended report and entered a final order regarding the stay period, mandatory mediation, and certain deadlines related thereto. Pursuant to the final order, certain of the Vendor Avoidance Actions remain stayed, pending decision on confirmation of the amended plan of adjustment.

These matters remain ongoing, and the Bank cannot predict when they will be concluded or its outcome.

***Litigation Related to or Resolved by the Qualifying Modification***

Several parties commenced litigation against the Bank related to the Qualifying Modification or that was resolved in connection with the Court’s approval of the Qualifying Modification. As such, all such litigation, which is further described below, has been resolved and is no longer pending.

*Caguas v. Government Development Bank for Puerto Rico, et al., Case No. 3:17-cv-01973-LTS (D.P.R. July 17, 2017).* On July 17, 2017, the Municipality of Caguas (Caguas) sued the Commonwealth, along with the Bank, the Oversight Board, FAFAA and CRIM to prohibit the Bank from restructuring its debt using the Qualifying Modification. The lawsuits contend that the GDB Restructuring Support Agreement (the GDB RSA) violates PROMESA and is unconstitutional. On September 11, 2017, FAFAA and the Bank filed a motion to dismiss the Caguas lawsuit. Caguas thereafter filed a voluntary motion to dismiss and the case was dismissed without prejudice on October 30, 2017.

*Autonomous Municipality of San Juan v. The Financial Oversight and Management Board for Puerto Rico, et al., Case No. 3:17-cv-02009-LTS (D.P.R. July 26, 2017).* On July 26, 2017, the Municipality of San Juan (San Juan) sued the Oversight Board in the United States District Court for the District of Puerto Rico seeking to prevent implementation of the GDB RSA, arguing it will unlawfully take the San Juan’s revenues to pay the Bank’s debt. San Juan’s complaint sought to invalidate the Oversight Board’s contingent approval of the GDB RSA and to permanently enjoin the GDB and FAFAA from submitting to the Oversight Board—and the Oversight Board from certifying—any Qualifying

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Modification that either fails to provide a separate voting pool for municipal depositors with setoff rights or contemplates the use of excess CAE trust funds for the benefit of non-municipal creditors. On August 25, 2017, San Juan filed a motion for a preliminary injunction, seeking to enjoin the Bank from soliciting votes on the GDB RSA. On September 27, 2017, Judge Swain denied the motion. On September 11, 2017, FAFAA and the Bank filed the motion to dismiss the complaint. On September 18, 2017, San Juan filed an informative motion informing the District Court that it intended to amend its complaint as a matter of course pursuant to Federal Rule of Civil Procedure 15(a)(1)(B). On September 19, 2018, GDB and San Juan entered into a settlement agreement to resolve San Juan's claims against GDB and San Juan's pending objections to the Qualifying Modification and on October 9, 2018, the Municipality of San Juan filed a motion for voluntary dismissal with prejudice of this suit, which was granted.

*The Official Committee of Unsecured Creditors of the Debtors (other than COFINA) v. The Commonwealth of Puerto Rico, et al.*, Case No. 18-00101-LTS (D.P.R. Sept. 6, 2018), On September 6, 2018, the Official Committee of Unsecured Creditors appointed in the Commonwealth Title III case (the Committee) filed a complaint for declaratory judgment and injunctive relief in the District Court against the Commonwealth, FAFAA, GDB, and the Oversight Board. The Committee sought declaratory relief stating that the GDB Restructuring Act is invalid and unenforceable. The complaint alleged, among other things, that the GDB Restructuring Act (i) amounts to a de facto bankruptcy law that is inconsistent with Title III of PROMESA; (ii) is preempted by PROMESA insofar as it purports to release rights and claims of the Title III Debtors unrelated to any bond affected by the Qualifying Modification; and (iii) is inconsistent with the automatic stay. The Committee also filed (i) two motions in the Title III cases seeking relief to challenge the Qualifying Modification, and (ii) a preliminary objection to the Qualifying Modification in the Title VI case. On October 5, 2018, GDB, FAFAA, the FOMB and the Committee entered into a stipulation, which was filed on the docket in the Title VI case, resolving the Committee objection to the Qualifying Modification and the adversary complaint. On November 30, 2018, the District Court entered an order closing this case.

*Siemens Transportation Partnership Puerto Rico, S.E. v. Puerto Rico Highways and Transportation Authority et al.*, Adversary Proceeding Case No. 17-03567 LTS (D.P.R. 2017). On March 26, 2018, Siemens Transportation Partnership Puerto Rico, S.E. ("Siemens"), filed an adversary proceeding against the Puerto Rico Highways and Transportation Authority ("HTA"), the Oversight Board, FAFAA, and the Bank. The complaint sought to collect monies and asserts a breach of contract claim in connection with a settlement agreement whereby Siemens was to receive the sum of \$52 million from HTA related to the construction of the Tren Urbano project. Specifically, Siemens requested the disbursement of the last completion payment of \$13 million, which, according to Siemens, was to be deposited in an escrow account at GDB. Accordingly, Siemens brought suit against, among others, HTA and GDB to collect on such monies, seeking a determination (i) that the completion payment has become due, (ii) that the monies in question are deposited in escrow at GDB, (iii) an injunction against the defendants prohibiting the dissipating of the funds allegedly held in escrow, and (iv) an order to release the monies to Siemens. On May 29, 2018, GDB, FAFAA and the FOMB filed motions to dismiss. GDB argued that (i) in the absence of a written agreement with GDB for the creation of an escrow account requiring GDB to segregate the funds from its liquidity, as a matter of Puerto Rico law, the funds are held in GDB deposits and not in escrow, and (ii) the case should be considered as part of GDB's Title VI proceedings given that Siemens' claim is with respect to a GDB deposit subject to the Qualifying Modification. Following a hearing held on July 25, 2018, the District Court entered an order ruling: the controversies posed in the adversary proceeding will be resolved in connection with GDB's Title VI proceeding. Siemens and Bank thereafter settled this claim in the context of the Qualifying Modification and in connection with the District Court's approval of the GDB Qualifying Modification under Title VI of PROMESA, the District Court dismissed this adversary proceeding with prejudice on November 30, 2018.

*Fundación Biblioteca Rafael Hernández Colón v. Commonwealth of Puerto Rico et al.*, Case No. JAC 17-0401. This complaint was filed on March 20, 2018, before the Puerto Rico Court of First Instance, by Fundación Biblioteca Rafael Hernández Colón against the Commonwealth, GDB and other defendants. The plaintiff alleged that Act 290-2000 established a special fund, to be capitalized with the proceeds of certain cigarette excise taxes, for the benefit of foundations established by former governors and first ladies, including the plaintiff. The plaintiff also alleged that GDB acts as trustee of such fund, which is held on deposit at GDB, and that moneys in such fund cannot be comingled with other funds deposited with GDB. The plaintiff further alleged that it obtained two loans with an aggregate

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outstanding principal balance of approximately \$1.4 million, which are secured by an assignment of the funds received by the plaintiff pursuant to Act 290-2000. The Fundación further filed an objection to the GDB Qualifying Modification. On October 31, 2018, GDB and the Fundación entered into a settlement agreement, which resolved its complaint and objection to GDB's Qualifying Modification.

*Fundación Sila M. Calderón, Inc. v. Estado Libre Asociado de Puerto Rico, Inc.*, Case No. SJ2018CV02952. This complaint was filed on May 7, 2018, before the Puerto Rico Court of First Instance, by Fundación Sila M. Calderón, Inc., against the Commonwealth, GDB and other defendants. The plaintiff's allegations and requests for relief are substantially similar to those made by the plaintiff in *Fundación Biblioteca Rafael Hernández Colón v. Commonwealth of Puerto Rico et al.*, discussed above. On July 20, 2018, the Puerto Rico Court of First Instance entered judgment staying the case and retaining jurisdiction to reopen upon request by the plaintiff. The Fundación further filed an objection to the GDB Qualifying Modification. On October 31, 2018, GDB and the Fundación entered into a settlement agreement, which resolved its complaint and objection to GDB's Qualifying Modification.

*Travelers Casualty & Surety Company v. Municipality of San Juan*, Case No. 17-01290. This complaint for breach of contract and collection of monies was filed on February 28, 2017, in the District Court by Travelers Casualty and Surety Company against the Municipality of San Juan. The plaintiff sought payment of \$338,656 allegedly owed by San Juan to a contractor with respect to two construction projects. San Juan admitted essential facts but filed a third-party complaint against GDB on July 12, 2017, claiming that the amounts due should be paid by GDB, as the funds for paying such contracts are allegedly deposited with, and under the control of, GDB. GDB filed a motion to dismiss the third-party complaint, arguing, among other things, that the municipality lacks standing to sue pursuant to Article 703 of the GDB Restructuring Act, which provides that no Puerto Rico government entity will have authority or standing to challenge or question the validity of GDB's restructuring process, which GDB argued would be the consequence of allowing the third-party complaint to go forward. On November 20, 2018, San Juan filed a notice of voluntary dismissal without prejudice of the third-party complaint against GDB. The District Court entered judgment dismissing the third-party complaint on November 30, 2018.

#### **(19) Conduit Debt and Programs**

The Public Finance Corporation has issued approximately \$8.1 billion of Commonwealth appropriation bonds (the Bonds) maturing at various dates through 2033. The proceeds of the Bonds, except for approximately \$4.6 billion, were used to provide the necessary funds to purchase from the Bank separate promissory notes of the Department of the Treasury and its public entities (the Promissory Notes). The \$4.6 billion referred to above was used to refund a portion of certain bonds issued by the Public Finance Corporation between fiscal years 1995 and 2005. The outstanding balance of the Bonds at June 30, 2017 amounted to approximately \$1.1 billion.

The Bonds are limited obligations of the Public Finance Corporation and, except to the extent payable from bond proceeds and investment earnings thereon, will be payable solely from a pledge and assignment of amounts due under the Promissory Notes. Principal and interest on the Promissory Notes are payable solely from legislative appropriations to be made pursuant to acts approved by the Legislature. These acts provide that the Commonwealth shall honor the payment of principal and interest on the Promissory Notes, and that the Director of the Office of Management and Budget shall include in the budget of the Commonwealth submitted to the Legislature the amounts necessary to pay the principal and interest on the Promissory Notes. The Promissory Notes represent debt of the issuing instrumentalities (all part of the Commonwealth or its component units), and, for purposes of the Public Finance Corporation, the Bonds are considered conduit debt. Neither the Bonds nor the Notes purchased with the proceeds therefrom are presented in the accompanying basic financial statements.

In December 2003, the Housing Finance Authority issued \$663 million in Capital Fund Program Bonds Series 2003 to lend the proceeds thereof to the Public Housing Administration, a governmental instrumentality of the Commonwealth. Public Housing Administration utilized such funds for improvements to various public housing projects in the Commonwealth. The Capital Fund Program Bonds Series 2003 are limited obligations of the Housing Finance Authority, which will be paid solely from an annual allocation of public housing capital funds when received from HUD and other funds available under

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the bonds indenture. Accordingly, these bonds are considered conduit debt and are not presented in the accompanying basic financial statements. The outstanding balance of these bonds amounted to \$117.6 million at June 30, 2017.

On August 1, 2008, the Housing Finance Authority issued the Capital Fund Modernization Program Subordinate Bonds amounting to \$384,475,000. The proceeds from the issuance were mainly used to finance a loan to a limited liability company (the "LLC") and pay the costs of issuance. The \$384,475,000 bonds are limited obligations of the Housing Finance Authority, payable primarily by a pledge and assignment of federal housing assistance payments made available by HUD, with an outstanding balance of approximately \$268 million at June 30, 2017.

**(20) Interfund (Internal) Balances and Transfers**

The following table is a summary of the interfund balances as of June 30, 2017, between governmental funds and proprietary funds:

<u>Receivable by</u>	<u>Payable by</u>	<u>Purpose</u>	<u>Amount</u>
Governmental fund:	Proprietary fund:		
AHS Programs	GDB Operating Fund	Demand deposits and capitalized interest	\$ 264,600
AHS Programs	GDB Operating Fund	Investment agreements	17,439,510
AHS Programs	GDB Operating Fund	Certificates of deposit	1,089,345
AHS Programs	GDB Operating Fund	Accrued interest receivable	<u>76,151</u>
		Subtotal	18,869,606
Proprietary fund:	Governmental fund:		
GDB Operating Fund	AHS Programs	Loans payable and accrued interest	(109,791,699)
Housing Finance Authority	Home Programs	Reimbursement of expenditures	(318,153)
Housing Finance Authority	HUD Programs	Reimbursement of expenditures	(2,062,804)
Housing Finance Authority	AHS Programs	Reimbursement of expenditures	<u>(9,867,121)</u>
		Total internal balances – net	<u>\$ (103,170,171)</u>

With the exception of investment agreements and accrued interest of approximately \$17.5 million and loans payable and accrued interest of approximately \$109.8 million, all the remaining amounts due from internal balances or due to internal balances are due within one year.

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The summary of interfund balances as of June 30, 2017, among proprietary funds, is as follows:

Receivable by	Payable by	Purpose	Amount
Proprietary funds:	Proprietary funds:		
Housing Finance Authority	GDB Operating Fund	Demand deposits	\$ 10,418,288
Development Fund	GDB Operating Fund	Demand deposits	4,583,313
Tourism Development Fund	GDB Operating Fund	Demand deposits	1,609,503
Public Finance Corporation	GDB Operating Fund	Demand deposits	1,188,559
Other nonmajor (Education Assistance Corporation)	GDB Operating Fund	Demand deposits and accrued interest	2,395,394
Other nonmajor (JMB Institute)	GDB Operating Fund	Demand deposits and accrued interest	127,955
Housing Finance Authority	GDB Operating Fund	Certificates of deposit	105,477,277
Tourism Development Fund	GDB Operating Fund	Certificates of deposit	156,951,720
Development Fund	GDB Operating Fund	Certificates of deposit	5,009,257
Housing Finance Authority	GDB Operating Fund	Accrued interest on deposits	222
Development Fund	GDB Operating Fund	Accrued interest on deposits	62,713
Tourism Development Fund	GDB Operating Fund	Accrued interest on deposits	946,276
Public Finance Corporation	GDB Operating Fund	Accrued interest on deposits	99
Other nonmajor (Education Assistance Corporation)	GDB Operating Fund	Accrued interest on deposits	199
Other nonmajor (JMB Institute)	GDB Operating Fund	Accrued interest on deposits	11
Total balance among proprietary funds eliminated			<u>\$ 288,770,786</u>

The following table is a summary of interfund transfers for the year ended June 30, 2017:

Transfer out	Transfer in	Transfer for	Amount
Proprietary funds-Housing Finance Authority	Governmental funds: AHS Program	Subsidy payments	\$ 3,777,024
Governmental funds- AHS Program	Proprietary funds-Housing Finance Authority	Operations	<u>(4,966,667)</u>
			<u>\$ (1,189,643)</u>

**(21) Funds Deficit**

As of June 30, 2017, the Home Program fund, the Affordable Housing Subsidy Programs fund, the GDB Operating Fund and the Tourism Development Fund reflect deficits of approximately \$2 million, \$66.5 million, \$4.6 billion and \$55.8 million, respectively. The Home Program fund deficit responds to intergovernmental revenue inflow being deferred in fund financial statements for being unavailable for current disposition; the Affordable Housing Subsidy Programs fund deficit is due to the amounts borrowed by the Housing Finance Authority from the Bank that were used to provide housing subsidies; while the GDB Operating Fund and the Tourism Development Fund deficits are due to the significant provisions for loans and guaranty losses having been provided over the past years as a result of such funds' continuing financial and repayment capacity deterioration.

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**(22) Subsequent Events**

Subsequent events were evaluated through July 30, 2020 to determine if any such events should either be recognized or disclosed in the 2017 basic financial statements. The subsequent events disclosed below are principally those related to debt activities, including credit rating downgrade events, fiscal plan related matters and other revenue and/or budget related matters that management believes are intrinsically related to the financial statements of the Bank. These might have been disclosed elsewhere in these financial statements, but management believes they require specific mentioning based on their relevance and materiality as a whole.

**(a) Budgetary Events and Related Legislation**

*(1) Fiscal Year 2018*

On May 31, 2017, Governor Ricardo Rosselló proposed a \$9.562 billion budget for fiscal year 2018. The budget ultimately approved for fiscal year 2018 did not include appropriations to the Bank. The approved budget also did not include appropriations for the payment of debt service by the Commonwealth and its public corporations.

*(2) Fiscal Year 2019*

The Oversight Board certified a budget in the amount of \$8.757 billion, which did not include appropriations to repay any of the Bank's outstanding loans.

*(3) Fiscal Year 2020*

The Oversight Board certified a budget in the amount of \$9.051 billion, which did not include appropriations to repay any of the Bank's outstanding loans.

**(b) Debt Related Activities**

*(1) Bond Credit Rating Downgrade*

Currently, and after a series of credit downgrades, the credit rating of the Bank is non-investment grade.

*(2) Non-Payment of PFC Bonds*

On July 15, 2015, PFC filed a notice with Electronic Municipal Market Access (EMMA) indicating that the Legislative Assembly of Puerto Rico (the Legislature) had not included in the approved budget for fiscal year 2016 the funds necessary to pay principal and interest on all outstanding PFC bonds. Such appropriation is the sole source of payment of principal and interest on PFC bonds. The first payment of debt service on PFC bonds for fiscal year 2016 came due on August 3, 2015, on which date PFC made a partial payment of interest in the amount of \$628,000 (of the approximately \$58 million payment due on that date) from funds held by PFC representing funds remaining from prior legislative appropriations. As of February 3, 2020, PFC had missed payments of debt service on its bonds in the aggregate amount of approximately \$431 million (\$160.6 million in principal and \$270.4 million in interest).

*(3) Default*

Pursuant to Executive Order (EO) 2016-14, the Bank has already missed the following bond payments:

*GDB Notes Series 2011B and 2016A*

Of the \$360 million in principal and \$9.4 million in interest due on the Notes Series 2011B on May 1, 2016, only interest of \$8.5 million was paid, with the remaining amount unpaid and subsequent required debt service continuing in default. Of the \$39.9 million GDB Notes Series 2016A (due to several state-chartered Puerto Rico cooperatives and credit unions), maturing on May 1, 2017, and related \$940 thousand in interest

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that was due on November 1, 2016 and another \$940 thousand in interest that was due on May 1, 2017, none were paid and remain in default.

*GDB Notes Series 2012A*

Of the required debt service due on August 1, 2017 (\$11.722 million in interest), February 1, 2018 (\$10.9 million in interest) and August 1, 2018 (\$10.9 million in interest) on the GDB Notes Series 2012A, all remained unpaid.

*GDB Notes Series 2010A, 2010B, 2010C, 2010D, 2011H, 2011I, 2013B-1*

Of the monthly debt service due on these series of notes from August 1, 2016 through November 1, 2018 (aggregating \$544.8 million and \$40 million in principal payment on Series 2011H and 2013B-1, respectively; and \$292.8 million in interest), all remained unpaid.

*GDB Notes Series 2006B*

Of the required debt service due on December 1, 2017 (\$10.635 million in principal and \$532.5 thousands in interest), all remained unpaid.

On November 29, 2018, all the aforementioned GDB Notes were cancelled in exchange for certain GDB Debt Recovery Authority Bonds, pursuant to the provisions of the Qualifying Modification and Act No. 109 of 2017, as further described in section (c) below.

*(4) Participation Agreement Payable*

On February 28, 2018, the participation agreement payable referred to in Note 13(d) was settled in a Release and Termination Agreement entered between the Tourism Development Fund and the participating financial institution, where such participation agreement was terminated through a discounted payment from the Tourism Development Fund in the amount of \$2,372,000. The remaining amount payable after this payment was offset against the corresponding remaining note receivable recorded for the same amount.

*(5) Settlement and Termination Agreements*

At various dates from fiscal years 2017 through 2019, the Bank and the Tourism Development Fund entered into several termination and settlement agreements involving some of its loans and guaranteed obligations, consisting mostly in relieving its claims on loans or obligations on guarantees in exchange for discounted pay-offs on loans and/or discounted pay-offs and conversion of such guaranteed obligations into Participating Bond Claims under the Qualifying Modification process of the GDB RSA described in Note 3 and below. In the case of such Participating Bond Claims conversion, upon the closing of the GDB RSA, such Participating Bond Claims would be exchanged for New Bonds at the exchange rate of 55%. The estimates of the allowance for loan losses (Note 8) and of the liability under guaranteed obligations for the applicable instances at June 30, 2017 (Note 15) reflect the effects of these subsequent settlement and termination agreements and the exchanges for the New Bonds on such loans and guarantee's expected cash flows. Some of the key projects for which termination and settlement agreements were entered and proposed consist of the following:

***GDB Operating Fund:***

- Guaranteed Obligation-Ports Authority PRIFA Series B Bonds
- Guaranteed Obligation-Lehman Brothers Debt Service Deposit Agreement



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***Tourism Development Fund:***

- Guaranteed Obligation-CCHPR Hospitality Sheraton Puerto Rico Hotel
- Guaranteed Obligation-CGDP Hotel Condado Lagoon Hilton Villas II
- Guaranteed Obligation-Embassy Suites Dorado del Mar
- Loan Financing-Royal Isabela
- Loan Financing-Flagship Verdanza Hotel
- Loan Financing-Embassy Suites Dorado del Mar

**(c) *Qualifying Modification and the Title VI Approval Process***

On November 29, 2018, the Bank completed a restructuring of certain of its indebtedness pursuant to a Qualifying Modification under Title VI of PROMESA (the Qualifying Modification). Under the Qualifying Modification, holders of the GDB Senior Notes and certain deposit claims against the Bank (each a Participating Bond Claim) exchanged their claims for bonds (at an upfront exchange ratio of 55%) issued by a newly created public instrumentality—the GDB Debt Recovery Authority created under Act No. 109 of August 24, 2017, known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the GDB Restructuring Act)—and the Bank transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash. In addition, pursuant to the GDB Restructuring Act, claims on account of deposits held by the Commonwealth and other public entities were exchanged for interest in a newly formed trust created pursuant to the GDB Restructuring Act, titled the Public Entity Trust (the PET).

On November 6, 2018, the United States District Court for the District of Puerto Rico approved the Qualifying Modification pursuant to section 601(m)(2) of PROMESA, and the Qualifying Modification became effective as of November 29, 2018. Pursuant to PROMESA, the Qualifying Modification is valid and binding on any person or entity asserting claims or other rights, including a beneficial interest (directly or indirectly, as principal, agent, counterpart, subrogee, insurer or otherwise) in respect of Participating Bond Claims, and any trustee, any collateral agent, any indenture trustee, any fiscal agent, and any bank that receives or holds funds related to such Participating Bonds. The Qualifying Modification, including all settlements, compromises, releases, discharges, and injunctions, were deemed by the District Court to be full, final, complete, binding, and conclusive as to the Commonwealth, all Commonwealth instrumentalities, and any creditors of such entities, and shall not be subject to any collateral attack or other challenge by any such entities in any court or other forum.

Under the GDB Restructuring Act, the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates (each a Non-Municipal Government Entity) and the Bank were determined by applying the outstanding balance of any deposits held at the Bank in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to the Bank or of any bond or note of such Non-Municipal Government Entity held by the Bank as of such date. Those Non-Municipal Government Entities having net claims against the Bank, after giving effect to the foregoing adjustment received their pro rata share of interests in the PET, which was deemed to be full satisfaction of any and all claims such Non-Municipal Government Entity may have against the Bank.

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The assets of the PET (the PET Assets) consist of, among other items, an unsecured claim of \$578 million, which is the subject of a proof of claim filed in the Commonwealth's Title III case (the PET Claim). Non-Municipal Government Entities' recoveries on account of their interests in the PET will depend upon the recovery ultimately received by the PET on account of the PET Assets. The Official Committee of Unsecured Creditors appointed in the Commonwealth Title III Case has objected to the PET Claim and, as of the date hereof, the Court has not determined if the PET Claim is an allowed claim that will be entitled to a distribution. Claims that the Commonwealth and other governmental entities may have had against the Bank have been released pursuant to the GDB Restructuring Act.

**(d) *PayGo Pension Reform***

On June 27, 2017, the Treasury Department issued Circular Letter No. 1300-46-17 to convey to the central government agencies, public corporations and municipalities the new implementation procedures to adopt, effective July 1, 2017, a new "pay-as-you-go" (PayGo) system. With the start of fiscal year 2018, employers' contributions, contributions ordered by special laws, and the Additional Uniform Contribution were all eliminated.

The PayGo system was one component of Act No. 106 of 2017 (Act 106-2017), which the Governor signed into law on August 23, 2017. Act 106-2017 created the legal framework so that the Commonwealth can guarantee benefit payments to current pensioners through the PayGo system. Approximately \$2 billion was allocated for these purposes in each of the budgets for fiscal year 2018 and fiscal year 2019. Act 106-2017 also created a Defined Contributions Plan, similar to a 401(k) plan, that will be managed by a private entity. Future benefits will not be paid by the Retirement Systems.

Act 106-2017, among other things, amended Act No. 12 with respect to ERS's governance, funding and benefits for active members of the actual program and new hired members. Under Act 106-2017, ERS's board of trustees was eliminated and a new Retirement Board was created. The Retirement Board is currently responsible for governing both ERS, the Judiciary Retirement System (JRS), and Teachers Retirement Systems (TRS).

Act 106-2017 terminated the previously existing pension programs for ERS participants as of June 30, 2017. The members of the prior programs and new system members hired on and after July 1, 2017 will be enrolled in a new defined contributions program that will be selected by the Retirement Board. The accumulated balance on the accounts of the prior program will be transferred to the member accounts in the new defined contributions program. ERS' active members of the defined contributions program will retain their benefits as stated under Act 91 of March 29, 2003.

Act 106-2017 also ordered a suspension of ERS's loan programs and ordered a merger of the administrative structures of the retirement systems. At the Retirement Board's discretion, the administration of ERS benefits may be externalized. The employees of ERS that are not retained under the new administrative structure will be transferred to other public agencies in conformity with Act No. 8 of February 8, 2017. In addition, Act 106-2017 repealed the Voluntary Early Retirement Law, Act No. 211 of 2015, while creating an incentives, opportunities and retraining program for public workers.

**(e) *Proposed Title III Joint Plan of Adjustment for the Commonwealth, ERS and PBA***

On September 27, 2019, the Oversight Board—as representative of the Commonwealth, ERS and PBA in their respective Title III cases—filed its initial joint Title III plan of adjustment for the Commonwealth, ERS, and PBA [ECF No. 8765] (the Initial Plan) along with a disclosure statement related thereto [ECF No. 8765] (the Initial Disclosure Statement), which was founded upon the pre-COVID-19 economic assumptions contained in the May 9, 2019 Board Fiscal Plan.

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On February 9, 2020, the Oversight Board announced that it entered into a plan support agreement (the PSA) with certain Commonwealth general obligation bondholders and PBA bondholders, which would require revisions to the Initial Plan. On February 28, 2020, the Oversight Board filed its Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al. [ECF No. 11946] (the Amended Plan) and an amended disclosure statement related thereto [ECF No. 11947] (the Amended Disclosure Statement), which revised the Initial Plan to conform to the PSA. When the Amended Plan was filed, the Commonwealth Government opposed it because the Oversight Board's proposed pension reduction measures imposed a disproportionate burden on Puerto Rico's retirees and did not properly take into account the improved treatment of bondholder claims and the cuts that Government pensioners already suffered prior to the commencement of the Title III cases, which was in contrast to pension treatment in other municipal bankruptcies.

The Amended Plan and Amended Disclosure Statement do not reflect the potential economic impact from the ongoing outbreak of COVID-19. As a result, on March 23, 2020, the Oversight Board filed an urgent motion requesting to adjourn consideration of the Amended Disclosure Statement—which had been scheduled for June 3 and June 4, 2020—until further notice. The Title III Court granted the motion on March 27, 2020, requiring the Oversight Board to file a status report on May 1, 2020. The Oversight Board filed its status report on May 1, 2020, but in light of the ongoing uncertainties related to COVID-19 has not made any determinations on the status of the Amended Plan and will provide a further status update on July 15, 2020. On May 3, 2020, the Governor submitted a revised fiscal plan proposal for the Commonwealth, noting that the Amended Plan is likely not feasible and should be subject to re-evaluation and potentially substantial revision because the economic assumptions upon which the Amended Plan is based do not reflect the substantial negative effects of COVID-19 (particularly with respect to debt sustainability and the economic impact of certain cost-cutting measures).

The Amended Plan and Amended Disclosure Statement remain subject to future amendments (particularly given the negative economic impacts of the COVID-19 pandemic) and Title III Court approval, and it is not certain that the Title III Court will ultimately confirm the Amended Plan.

For additional information, refer to the publicly available Amended Plan and Amended Disclosure Statement, available at <https://cases.primeclerk.com/puertorico/Home-DocketInfo>.

**(f) *Puerto Rico Housing Finance Authority***

As part of the efforts of the Government of Puerto Rico to maximize resources through consolidation of governmental structures in order to achieve greater levels of efficiency, the Governor of Puerto Rico informed the U.S. Department of Housing and Urban Development the transfer of the HOME Program from the Puerto Rico Housing Finance Authority to the Puerto Rico Department of Housing. Such transfer was effective on March 1, 2019.

On January 6 and 7, 2020, Puerto Rico sustained a series of strong earthquakes, which caused significant damages to individual and family housing as well as to public schools and small businesses, predominantly concentrated in several municipalities in the southwestern part of the island. These earthquakes have been followed by hundreds of aftershocks that have continued to recur through the date of these financial statements. Management has not identified yet the impact, if any, that these earthquakes may have on the Puerto Rico Housing Finance Authority's programs or operations. Through the date of these financial statements, no claims have been made or received through the Puerto Rico Housing Finance Authority's mortgage loan insurance programs.

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**(g) *Coronavirus Pandemic***

**(1) *Executive Orders***

On March 11, 2020, the World Health Organization declared the Coronavirus disease caused by a novel coronavirus (COVID-19) as a global pandemic. As a result of the health threat and to contain the virus spread across the island, Governor Vázquez-Garced issued executive order OE 2020-020, on March 12, 2020, declaring a state of emergency in Puerto Rico to concentrate all efforts and implement necessary measures to safeguard the health, well-being and public safety of the citizens of Puerto Rico. The executive order authorizes the Secretary of the DOT and the Executive Director of the PROMB to set up a special budget, from any available funds, including the Emergency Fund, to cover all necessary costs for the containment of the virus throughout the island and share information with the municipalities.

On March 15, 2020, the Governor issued executive order OE 2020-023 ordering a curfew for all citizens requiring them to stay at home from 9 p.m. to 5 a.m., allowing them to use the public roads, within this time frame, under specific circumstances such as: (1) purchasing food, pharmaceutical and basic necessity products; (2) keeping medical appointments or visiting a hospital, laboratory, or healthcare facility; (3) commuting, for public and private employees who provide essential services; (4) returning to place of residence from an allowed activity; (5) providing assistance, care, transportation of senior citizens, children, dependents, people with disabilities or requiring medical or professional attention; and (6) visiting financial institutions, provided that all necessary precautions are taken to prevent the risk of spreading the disease. Also, the executive order mandated that any person with reasonable suspicion of being exposed to the COVID-19 virus remain quarantined for fourteen (14) days, as of the issuance of the order, to prevent them from posing a risk to public health and transmission to non-infected persons. In addition, it ordered the closure of all governmental operations, except for those related to essential services, and the closure of all businesses in Puerto Rico from March 15, 2020, at 6 p.m., until March 30, 2020, unless otherwise provided. Furthermore, the order established criminal penalties and fines for any person who failed to comply with the evacuation orders issued by the Commonwealth's Public Safety Department or its Bureaus.

On March 30, 2020, the Governor issued executive orders OE 2020-029 and OE 2020-030 ordering a lockdown in Puerto Rico. The citizens of Puerto Rico were instructed to stay at their residences the 24 hours of a day for the 7 days of the week from March 31, 2020 to April 12, 2020 and only be allowed to use the public roads, during the hours between 5 a.m. and 7 p.m., under the circumstances previously allowed by OE 2020-023. Additionally, under these measures, a transit order was introduced, based on the last number of the vehicle license plates, permitting citizens to use their cars to buy food, pharmaceutical and basic necessity products, visit financial institutions and receive specified allowed services. Moreover, the order provided a description of the services and businesses that were allowed to operate during the emergency; it informed citizens that the collection of tolls fees would be reinstated after March 31, 2020; provided a limited window for payroll related employees to visit their employer's offices to process the payroll payments for the month of March; ordered the DNER to shut down all docks to discourage the maritime traffic of recreational boats and authorized the establishment of a surveillance plan of the island's coasts, in coordination with the state and municipal police to enforce compliance with the instructions provided by executive order; and established a mandatory 14-day quarantine for all passengers arriving to the Luis Muñoz Marín international airport.

On April 12, 2020, the Governor issued executive order OE 2020-033 extending the curfew imposed on the citizens of Puerto Rico and the control measures implemented to contain the spread of COVID-19 through the island until May 3, 2020. On May 1, 2020, the Governor issued executive order OE 2020-038, which extended the curfew and other COVID-19 control measures through May 25, 2020 but also lifted certain business restrictions to allow limited openings of certain industries, shops, and services at specific times while continuing to observe social distancing rules. The initial reopening was limited to primary and specialist doctors and dentists, animal shelters, vehicle repair and parts services, laundromats, elevator inspections, services to ports

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and airports, air conditioner repair and maintenance services, notary services, and critical infrastructure services, among others. On April 14, 2020, the Governor issued Executive Order OE 2020-034 extending the lockdown period through May 3, 2020.

On May 1, 2020 and May 21, 2020, the Governor issued two further orders, extending the lockdown measures until May 25 (Executive Order OE 2020-038) and June 15 (Executive Order OE 2020-041) respectively. Executive Order OE 2020-038 also set out guidelines to be observed by operating establishments, including requiring face coverings onsite, requiring employees to wash their hands frequently, requiring facilities to be available for people to disinfect their hands onsite, requiring people to maintain six feet distance onsite, and requiring businesses to consider special operating hours for those over 65. It also provided measures for the hosting of religious events electronically and permitted the operation of construction and manufacturing industries from May 11, 2020 onwards. Executive Order OE 2020-038 continued to ease the lockdown measures, expanding the list of exempt businesses to include barbershops and beauty salons, car washing businesses, retail sales businesses, malls, car dealerships, travel agencies and IT businesses, attaching certain conditions to their re-opening.

On May 15, 2020, the Governor issued Executive Order OE 2020-040, which approved a strategic plan for addressing the COVID-19 crisis going forward, centered around three pillars: (1) testing, tracing, isolation and treatment; (2) continuity of government services; and (3) reactivation of the economy in a phased manner and protection of workers. To affect implementation of the plan, the Governor ordered that the Department of the Treasury, the Office of Management and Budget, and AAFAF provide technical assistance, lead and supervise all agencies, and distribute federal funds pursuant to the plan.

On June 12, 2020, the Governor issued Executive Order OE 2020-044, which established a “new lockdown,” effective until June 30, 2020, lifting the previous lockdown, to take effect between the hours of 10:00pm and 5:00am. The order re-established the requirement for any person suspected of exposure to COVID-19 to quarantine for fourteen days and reiterated public safety guidelines and exemptions. The order also permitted the re-opening of outdoor recreational activities, public beaches, the horse racing industry, as well as the use of outdoor spaces for entertainment. It further provided that efforts would be made to promote tourism.

On June 29, 2020, the Governor issued Executive Order OE 2020-048, which extended the lockdown through July 22, 2020, and continued to expand economic reopening measures by, for example, permitting advertising agencies, movie theatres, museums, gyms, childcare centers and businesses in the film industry to re-open under certain conditions.

On June 30, 2020, the Governor extended the emergency period for an additional six months, until December 31, 2020, through Executive Order OE 2020-050.

As the Government observes and assesses the results of the reopening, it will continue to re-evaluate and further amend business restrictions as necessary to promote economic recovery while preserving the health, welfare and safety of the people of Puerto Rico.

*(2) Economic Stabilization Measures*

On March 23, 2020, the Oversight Board agreed with the Commonwealth to provide support to the Puerto Rican people, frontline workers, educators and students, and small businesses. The \$787 million Emergency Measure Support Package consists of \$500 million that had to be authorized as an incremental appropriation to the fiscal year 2020 General Fund budget in compliance with the budgetary process under PROMESA, \$157 million of reappropriation within the current fiscal year 2020 Commonwealth General Fund budget, and \$131 million of Federal funds. This Emergency Measures Support Package is in addition to the availability of \$160 million from Puerto Rico’s Emergency Reserve Fund the Oversight Board had already authorized.

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2017

On March 27, 2020, President Trump signed into law the Coronavirus, Aid, Relief, and Economic Security Act (the "CARES Act"), commonly known as "Phase Three" of coronavirus economic relief. The CARES Act provides a stimulus to individuals, businesses, and hospitals in response to the economic distress caused by the COVID-19 pandemic; creates a \$349 billion loan program for small businesses, including 501(c)(3) non-profits and physician practices; allocates \$500 billion for assistance to businesses, states, and municipalities; expands telehealth services in Medicare, including services unrelated to COVID-19 treatments; expands eligibility for unemployment insurance and provides people with an additional \$600 per week on top of the unemployment amount determined by each state; expands the Defense Production Act, allowing for a period of two years when the government may correct any shortfall in resources without regard to the current expenditure limit of \$50 million; provides the U.S. Secretary of the Treasury with the authority to make loans or loan guarantees to states, municipalities, and eligible businesses and loosens a variety of regulations prior legislation imposed through the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Economic Stabilization Act of 2008, and others; and authorizes supplemental appropriations to help the government respond to COVID-19 pandemic emergency.

The Commonwealth also enacted Law 57 of 2020, the Complementary Law to Address the Effects on the Puerto Rican Economy Caused by the COVID-19 Emergency, which provides additional tax and other economic incentives in response to the economic impact of the COVID-19 pandemic, which includes, among other measures, eliminating the 4% business to business tax on services for three months, allowing businesses to "carry back" losses caused by the COVID-19 pandemic to two previous tax years, exempting from tax any COVID-19 related subsidy payments and suspending a \$500 minimum corporate tax.

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**REQUIRED SUPPLEMENTARY INFORMATION**

**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
(A Component Unit of the Commonwealth of Puerto Rico)  
**REQUIRED SUPPLEMENTARY INFORMATION**  
**SCHEDULE OF PROPORTIONATE SHARE OF THE**  
**NET PENSION LIABILITY AND RELATED RATIOS (UNAUDITED)**  
June 30, 2017

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Proportion of the Net Pension Liability	0.53945%	0.51093%	0.50017%	0.49312%
Proportionate Share of the Net Pension Liability	203,366,767	170,329,583	151,057,272	135,869,444
Covered - Employee Payroll	18,221,102	18,925,985	18,397,181	19,040,305
Proportionate Share of the Net Pension Liability as Percentage of Covered-Employee Payroll	1116.11%	899.98%	821.09%	713.59%
Plan Fiduciary Net Position as a Percentage of the Net Pension Liability	-6.84%	-4.05%	0.54%	5.00%

See accompanying independent auditors' report



**GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**  
(A Component Unit of the Commonwealth of Puerto Rico)  
**REQUIRED SUPPLEMENTARY INFORMATION**  
**SCHEDULE OF CONTRIBUTIONS (UNAUDITED)**  
June 30, 2017

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Contractually Required Contribution (Statutorily Determined)	7,304,700	3,988,550	3,686,088	936,705
Contributions in Relation to the Statutorily Required Contribution	7,605,196	4,278,350	3,926,488	3,012,117
Contribution Deficiency (Excess)	(300,496)	(289,800)	(240,400)	(2,075,412)
Covered - Employee Payroll	18,221,102	18,925,985	18,397,181	19,040,305
Contributions as a Percentage of Covered-Employee Payroll	41.74%	22.61%	21.34%	15.82%

Note: Information is required to be provided for ten years. Additional years will be included as they become available.

See accompanying independent auditors' report