Puerto Rico Development Fund

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

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

PUERTO RICO DEVELOPMENT FUND
(A Component Unit of Government Development Bank for Puerto Rico)

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INDEPENDENT AUDITORS' REPORT

The Members of the Board of Directors of
Puerto Rico Development Fund:

We have audited the accompanying balance sheet of Puerto Rico Development Fund (the "Development Fund"), a component unit of Government Development Bank for Puerto Rico, as of June 30, 2011, and the related statements of revenues, expenses, and change in net assets, and of cash flows for the year then ended. These financial statements are the responsibility of the Development Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

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

Deloitte & Touche LLP

December 1, 2011

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affixed to original.

PUERTO RICO DEVELOPMENT FUND
(A Component Unit of Government Development Bank for Puerto Rico)

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

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

(1) Financial Highlights

- The Development Fund's net assets decreased approximately $12.4 million or 36.6% during the course of the year's operations mainly because of the net effect of decreases of approximately $15 million in cash and $4 million in investments, and an increase of approximately $6 million in loans receivable - net.
- Interest income on deposits decreased from approximately $27,898 in fiscal year 2010 to $17,092 in fiscal year 2011 because of a reduction on the average cash balance due to the disbursement of cash in lending facility.
- Dividend income decreased from approximately $429,807 in fiscal year 2010 to approximately $320,976 in fiscal year 2011 mainly due to the decrease in the investment from Productos Avícolas de Puerto Rico.
- The Development Fund originated a loan during fiscal year 2011. This loan was approved and disbursed for $8,567,000.

(2) Overview of the Financial Statements

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

(3) Required Financial Statements

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

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

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

(4) Financial Analysis of the Development Fund

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

(5) Net Assets and Changes in Net Assets

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

	June 30		Change	
	2011	2010	Amount	Percent
Assets:				
Current assets	$ 11,237	$ 28,708	$ (17,471)	(60.9)%
Noncurrent assets	11,698	7,600	4,098	53.9 %
Total assets	$ 22,935	$ 36,308	$ (13,373)	(36.8)%
Current liabilities	$ 1,504	$ 2,496	$ (992)	(39.7)%
Net assets	21,431	33,812	(12,381)	(36.6)%
Total liabilities and net assets	$ 22,935	$ 36,308	$ (13,373)	(36.8)%

During fiscal year 2011, the Development Fund acquired from a private financial institution a loan originally used to finance the development and construction of a residential/commercial/office mixed-use condominium near to Puerto Rico Convention Center District for $8.5 million (Plaza CCD Loan). Total assets net decrease of approximately $12.3 million is directly related to the disbursement for Plaza CCD Loan and the disbursement in connection with the guarantees issued for loans granted by another government agency for the *Key for Your Business* program that amounted to $2.5 million, and a net decrease in the fair value of investment of approximately $4 million.

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

	Year ended June 30,		Change	
	2011	2010	Amount	Percent
Operating revenues:				
Interest income on deposits placed with Government Development Bank for Puerto Rico	$ 17	$ 28	$ (11)	(39.3)%
Interest income on loans	-	13	(13)	(100.0)%
Dividend income	321	430	(109)	(25.3)%
Net increase (decrease) in fair value of investments	(1,772)	151	(1,923)	(1273.5)%
Guaranty fees	-	4	(4)	(100.0)%
Total operating revenues	(1,434)	626	(2,060)	(329.1)%
Operating expenses	10,947	3,555	7,392	207.9 %
Change in net assets	(12,381)	(2,929)	(9,452)	322.7 %
Net assets – beginning of year	33,812	36,741	(2,929)	(8.0)%
Net assets – end of year	$ 21,431	$ 33,812	$ (12,381)	(36.6)%

The Development Fund experienced a loss in net assets as a result of the provision for loan losses of approximately $9 million which resulted from the economic situation of Productos Avícolas de Puerto Rico,.

(6) Contacting the Development Fund's Financial Management

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

PUERTO RICO DEVELOPMENT FUND
(A Component Unit of Government Development Bank for Puerto Rico)

BALANCE SHEET
AS OF JUNE 30, 2011

ASSETS

CURRENT ASSETS:	
Cash	$11,182,784
Interest and dividend receivable	54,433
Loan receivable — net	8,055,316
Total current assets	19,292,533
NONCURRENT ASSETS — Investments	3,642,563
TOTAL	$22,935,096

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:	
Accrued expenses and other liabilities	$ 4,563
Allowance for losses on guarantees	1,500,000
Total current liabilities	1,504,563
NET ASSETS	21,430,533
TOTAL	$22,935,096

See notes to basic financial statements.

PUERTO RICO DEVELOPMENT FUND
(A Component Unit of Government Development Bank for Puerto Rico)

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

OPERATING REVENUES:	
Interest income on deposits	$ 17,092
Dividend income	320,976
Total operating revenues	338,068
OPERATING EXPENSES:	
Provision for loan losses	9,319,708
Provision for losses on guarantees	1,496,066
Professional services	33,790
Decrease in fair value of investments	1,772,020
Management fees to Government Development Bank for Puerto Rico	30,000
Other	67,988
Total operating expenses	12,719,572
OPERATING LOSS AND CHANGE IN NET ASSETS	(12,381,504)
NET ASSETS — Beginning of year	33,812,037
NET ASSETS — End of year	$21,430,533

See notes to basic financial statements.

PUERTO RICO DEVELOPMENT FUND
(A Component Unit of Government Development Bank for Puerto Rico)

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

CASH FLOWS FROM OPERATING ACTIVITIES:	
Management fees paid	$ (30,000)
Payments to service providers and others	(102,149)
Payments for guarantees — net	(2,486,870)
Net cash used in operating activities	(2,619,019)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from redemption of investments	2,375,000
Interest and dividends received	339,799
Origination of loans	(15,176,274)
Net cash used in investing activities	(12,461,475)
NET DECREASE IN CASH	(15,080,494)
CASH — Beginning of year	26,263,278
CASH — End of year	$ 11,182,784
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:	
Operating loss	$(12,381,504)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Dividend and interest income	(338,068)
Decrease in fair value of investments	1,772,020
Provision for loan losses	9,319,708
Provision for losses on guarantees	1,496,066
Changes in operating liabilities:	
Decrease in accrued expenses and other liabilities	(371)
Payment of guarantees — net	(2,486,870)
Net cash used in operating activities	$ (2,619,019)
NONCASH INVESTING ACTIVITIES — Decrease in fair value of investments	$ 1,772,020

See notes to basic financial statements.

1. REPORTING ENTITY

Puerto Rico Development Fund (the "Development Fund") is a component unit of Government Development Bank for Puerto Rico (the "Bank").

The Development Fund was created by resolution of the Bank's board of directors on April 14, 1977 to expand the sources of financing available for the development of the private sector of the economy of Puerto Rico and to complement the Bank's lending program. The Development Fund may also guarantee obligations of private sector enterprises and invest in their equity securities. The Development Fund is exempt from taxation in Puerto Rico.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

Following is a description of the Development Fund's most significant accounting policies:

Measurement Focus, Basis of Accounting, and Financial Statements Presentation — The Development Fund's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred, regardless of the timing of related cash flows.

Operating Revenues and Expenses — Proprietary funds distinguish operating revenues and expenses from nonoperating items. The principal operating revenues of the Development Fund are interest and dividends earned on deposits, investments and loans, and fees on guarantees issued. Operating expenses are those related to the administration of the Development Fund.

Investments — Investments in debt securities and preferred stock that either is required to be redeemed by the issuing entity or is redeemable at the option of the investor, are reported at fair value. Investments in preferred stock, excluding preferred stock that either is required to be redeemed by the issuing entity or is redeemable at the option of the investor, are reported at fair value when it is readily determinable. If fair value is not readily determinable preferred stock are reported at cost, adjusted for other-than-temporary impairment. Fair value is determined based on quotations received from independent broker/dealers. Realized gains and losses from the sale of investments, unrealized changes in the fair value of outstanding investments, and other-than-temporary impairment losses are included in net increase (decrease) in fair value of investments.

Loans and Allowance for Loan Losses — Loans are presented at the outstanding unpaid principal balance reduced by any charge-offs and the allowance for loan losses. The accrual of interest on loans ceases when loans become past due over six months. Once a loan is placed in nonaccrual status, all accrued interest receivable is reversed from interest income. Interest income on nonaccrual loans is thereafter recognized as income only to the extent actually collected. Management reinstates a nonaccrual loan to accrual when the borrower has totally satisfied all amounts due.

The allowance for loan losses is established through provisions charged to operations. The allowance is based on management's evaluation of the risk characteristics of the loans, including such factors as the nature of individual credits outstanding, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and general economic conditions. Loan charge-offs are recorded against the allowance when management believes that the collectibility of the principal is unlikely. Recoveries of amounts previously charged off are credited to the allowance for loan losses. Because of uncertainties inherent in the estimation process, management estimate of credit losses in the outstanding loans receivable portfolio and the related allowance may change in the near future.

Loans considered to be impaired are generally reduced to the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent, by allocating a portion of the allowance for loan losses to such loans. If these allocations cause increases to the allowance for loan losses, such increase is reported as provision for loan losses. Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Development Fund will be unable to collect all amounts due according to the contractual terms of the loan agreement. Interest income and cash receipts on impaired loans are accounted predominantly in the same manner as nonaccrual loans.

Allowance for Losses on Guarantees — Management periodically evaluates the credit risk inherent in the guarantees issued to the Economic Development Bank for Puerto Rico (EDB), a component unit of the Commonwealth of Puerto Rico. The allowance is based on management's evaluation of the inherent risk of the loans granted by EDB under The Key for Your Business Program. The Development Fund reserves one-third of principal balance plus interest and certain other charges accrued for loans over 90 days in arrears. Payments of guarantees for defaulted loans are recorded against the allowance when EDB makes the requests to the Development Fund. Recoveries of amounts previously paid are credited to the allowance for guarantees.

3. CASH

Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the Development Fund's may not be able to recover its deposits. The depository bank balance, which equals bank balance, of $11,182,784 as of June 30, 2011 represents interest-bearing demand deposits with the Bank and was uninsured and uncollateralized.

4. INVESTMENTS

In accordance with investment guidelines promulgated by the Bank for agencies and public corporations of the Commonwealth under the authority provided by Act 113 of August 3, 1995 and Executive Order 1995-50A (the investment guidelines), the Development Fund is authorized 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 of Puerto Rico, its agencies, municipalities, public corporations, and instrumentalities
- Federal funds sold
- Securities purchased under agreements to resell
- 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 of Puerto Rico
- 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

The investment guidelines also establish limitations and other guidelines.

By resolution of the Bank's board of directors of April 14, 1977, which created the Development Fund, it is also authorized to invest in equity securities of private sector enterprises.

On April 30, 2008, the Development Fund purchased 135,148 shares in the *Grupo HIMA — San Pablo, Inc.* cumulative preferred stock, Series A 2007, with par value of $1.00, and issue price of $25.00 per share. At June 30, 2011, the carrying value of these shares was approximately $3.4 million.

The cumulative preferred shares have a stated dividend rate of 9.5% per annum, payable monthly. In the event that dividends accumulate unpaid for a period of six months, then, commencing on the seventh month, the dividend will increase by 2% to 11.5% per annum payable monthly. Dividends continue to accumulate at the higher rate until all accumulated dividends are paid.

The shares have an optional redemption clause that may be exercised by the investee at any time on or after the fifth anniversary of the date of the last sale of Preferred Shares – Series A 2007 at the following prices per share plus any accrued and unpaid dividends.

Redemption Period	Price
On or after the 5th and prior to the 10th anniversary	$ 26.750
On or after the 10th and prior to the 11th anniversary	25.500
On or after the 11th and prior to the 12th anniversary	25.375
On or after the 12th and prior to the 13th anniversary	25.250
On or after the 13th and prior to the 14th anniversary	25.125
On or after the 14th anniversary	25.000

On March 6, 2010, the Development Fund originated a facility of $14.3 million to Productos Avícolas del Caribe (PAC) that included a loan and the purchase of 4,750 shares Series A Preferred Stock, with par value of $1,000 per share. Dividends on the preferred shares were cumulative and accrued at a rate per annum equal to the lesser of 7.00% or 4.00% plus the Citibank, N.A. prime rate, payable monthly commencing on April 1, 2010. The Development Fund had the option to convert the Series A Preferred Stock into common stock of PAC commencing on March 1, 2015, if all amounts payable to the Development Fund under the loan had not been paid in full. The Series A Preferred Stock were required to be redeemed by PAC with proceeds from the sale and issuance for cash to persons other than the Development Fund of shares of PAC's capital stock and from amounts received by PAC under the Puerto Rico Department of Agriculture's Investment Program under Act No. 225 of December 1, 1995. These Series A Preferred Stock were also subject to redemption, at the option of PAC, upon not less than 30 nor more than 60 days' notice to the Development Fund. On July 16, 2010, a total of 2,300 shares with par value of $1,000 were redeemed.

At June 30, 2011, the outstanding shares of the Series A Preferred Stock were 2,125 with a carrying value of zero. Accumulated and unpaid dividends at June 30, 2011 amounted to approximately $53,000.

5. LOANS RECEIVABLE

As part of the credit facilities offered by the Development Fund, it has provided direct loans to economic development projects.

Total loans receivable as of June 30, 2011 consist of approximately $8.1 million, net of an allowance for possible loan losses of approximately $9.3 million.

On December 10, 2010, the Development Fund purchased from a private financial institution a loan originally used to finance the development and construction of Plaza CCD, a residential/commercial/office mixed-use condominium near to Puerto Rico Convention Center District.

The Development Funds expects to recover on or before December 31, 2011, the carrying value at June 30, 2011 of the $8.5 million loan to Plaza CCD from the Puerto Rico Convention Center District Authority, another public corporation and instrumentality of the Commonwealth of Puerto Rico (the "Authority"). The Development Fund's management bases its position on a resolution adopted by the Board of Directors of the Authority, dated October 20, 2011.

The following is a summary of private sector loans considered to be impaired as of June 30, 2011, and the related interest income for the year then ended (in thousands):

Recorded investment in impaired loans:	
Not requiring an allowance for loan losses	$ -
Requiring an allowance for loan losses	17,375
Total recorded investment in impaired loans	$ 17,375
Related allowance for loan losses	$ 9,320
Average recorded investment in impaired loans	$ 8,465

No interest was recognized on impaired loans during the year ended June 30, 2011.

The following is a summary of the activity in the allowance for loan losses for the year ended June 30, 2011 (in thousands):

Balance — beginning of year	$ -
Provision for loan losses	9,320
Net charge-offs	
Balance — end of year	$ 9,320

6. MANAGEMENT FEES

The Development Fund has no employees. The Bank provides management services to the Development Fund for which the Development Fund is charged a monthly fee. Total management fees charged during the year ended June 30, 2011 amounted to $30,000.

7. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

In the normal course of business, the Development Fund 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. These instruments involve, to varying degrees, elements of credit risk in excess of amounts recognized in the accompanying balance sheet. These off-balance-sheet risks are managed and monitored in manners similar to those used for on-balance-sheet risks. The Development Fund's exposure to credit losses for lending commitments is 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 might expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Development Fund 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. At June 30, 2011, the Development Fund had no commitments to extend credit.

8. COMMITMENTS AND CONTINGENCIES

The Development Fund has entered into an agreement (the "Agreement") with Economic Development Bank whereby the Development Fund guarantees a portion of loans granted by EDB under a government program named The Key for Your Business (the "Program"). Under the Agreement, the Development Fund would assign $10 million of its capital for the program. On August 28, 2008, the Development Fund and EDB amended the Agreement to increase from $10 million to $15 million the capital designated for the 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 guarantee fee and no loan can exceed $50,000. At June 30, 2011, the outstanding balance of loans guaranteed by the Development Fund amounted to approximately $14.2 million and the allowance for losses on guarantees amounted to approximately $1.5 million.

9. ALLOWANCE FOR LOSSES ON GUARANTEES

Following is the activity in the allowance for losses on guarantees for fiscal year 2011:

	Beginning Balance	Provision	Reductions	Ending Balance
Allowance for losses on guarantees	$2,490,804	$1,496,066	$2,486,870	$1,500,000

10. NET ASSETS

The Development Fund had internally designated $15,000,000 of its net assets in connection with guarantees issued for loans of the Key for Your Business Program of EDB. As of June 30, 2011, the balance of the designated net assets is $7,287,233.

11. SUBSEQUENT EVENTS

Subsequent events were evaluated through December 1, 2011, the date the financial statements were available to be issued, to determine if any such events should either be recognized or disclosed in the financial statements. Management has determined that there are no material events or transactions that would affect the Development Fund's financial statements through such date.

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