STANDARD & POOR'S

RATINGSDIRECT®

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Government Development Bank For Puerto Rico

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Government Development Bank For Puerto Rico

Major Rating Factors

Counterparty Credit Rating
BBB/Stable/A-2

Strengths:

- Strong capital on a risk-adjusted basis
- Limited credit risk exposures

Weaknesses:

- Increasing demands for financial support from the Treasury and other government/municipal entities because of the structural budget deficit
- Business and geographic concentration

Rationale

Standard & Poor's Ratings Services' ratings on the Government Development Bank for Puerto Rico (GDB) reflect its improved liquidity profile and the refortification of GDB's capital base and balance sheet. It also reflects improved fiscal management at the commonwealth level, exemplified by the formalization of structural limitations on the government's ability to borrow from GDB and the establishment of a dedicated repayment source for some pre-existing GDB loans in the form of sales tax proceeds. In fiscal 2007, GDB made a concerted effort to reduce its loan exposure to the commonwealth government and lowered this exposure by nearly $1.7 billion at the fiscal quarter ended Sept. 30, 2007. The loans were repaid using proceeds from the new sales tax. These proceeds were from a 'A+' rated, $4 billion Sales Tax Financing Corp. (COFINA) issue, with up to a 50-year maturity. Some of the proceeds were used to repay pre-existing GDB loans made to the commonwealth Treasury. This rating action does not affect our current ratings on the Commonwealth of Puerto Rico.

GDB is currently operating under a policy that will limit loans made directly to the government and keep its loan portfolio below 50% of total assets. Also, as part of the commonwealth's fiscal reform package, a law was passed that prevents the government from borrowing from GDB for deficit-financing purposes. Finally, the new sales tax in Puerto Rico was raised to 7%, with 1% of the sales tax proceeds now allocated toward repaying pre-existing GDB loans. GDB's outstanding loans to the government, which have this dedicated source of repayment, total $1 billion or 25% of their loan portfolio as of Sept. 30, 2007.

Although GDB's financial profile has had a short turn-around time, the dedication of 1% of the sales tax proceeds to repay pre-existing GDB loans is a positive improvement to GDB's credit profile. The current ratings also reflect our expectation for financial discipline for liquidity to remain a permanent strategy, regardless of the likely changes to GDB's president and administration, which are typically associated with a gubernatorial election year in Puerto Rico.

GDB was created in 1948 as a public corporation of the commonwealth and is governed by a seven-member board of directors, appointed by the Governor of Puerto Rico. The bank's primary business is as a fiscal agent for the commonwealth and to aid Puerto Rico's economic development. In line with this mandate, the bank acts as a fiscal agent and advisor, in connection with all borrowings and bond issues of the commonwealth, its public corporations, municipalities, and instrumentalities. GDB also makes loans to the commonwealth, purchases and guarantees obligations of the commonwealth and related entities, accepts commonwealth deposits, and makes loans to the private sector on a very limited basis.

Outlook

The outlook is stable. The ratings also reflect GDB's close business ties and financial support to a variety of the commonwealth's local municipalities and agencies. During the past year, the government and municipal entities have decreased their reliance on longer term financing in the form of loans from GDB, and we expect this trend to continue. Our outlook also reflects our expectation that GDB will continue to retain the vast majority of its net earnings, which should benefit its capital base. The commonwealth is still resolving its structural budget deficit which, if unresolved, could place GDB's liquidity and capital position at risk. As a result, the rating differential between GDB and the commonwealth is limited to one notch. The ratings could be negatively affected if the outcome of the elections results in changes that negate some of the fiscal improvements that were achieved this year.

Profile

GDB is a public corporation and a unit of the Commonwealth of Puerto Rico, created by Act No. 17 of Sept. 23, 1948. The bank charter provides for its perpetual existence and that no amendment to the charter or to any other law of Puerto Rico shall impair any outstanding obligations or bank commitments. GDB's principal functions are to act as fiscal agent and financial advisor for the commonwealth and its public entities and to make loans to public entities and private enterprises that will further Puerto Rico's economic development. In its role as fiscal agent, GDB acts as an advisor to the commonwealth and its instrumentalities in connection with all their borrowings, and GDB receives fees for its services.

These duties include serving as the main depository of Puerto Rico's public funds. GDB also acts as the Chief Investment Officer for the Government of Puerto Rico and as the fiscal manager of Puerto Rico's outstanding debt. GDB's initiatives and its diverse network of subsidiaries and affiliates are aimed at furthering Puerto Rico's socioeconomic development. GDB is exempt from taxation in Puerto Rico, except for excise taxes. GDB's charter allows the bank to invest in securities issued by any corporate entity engaged in Puerto Rico's economic development, as well as to guarantee loans and other obligations incurred by public and private entities.

In managing the public-sector finances, GDB's responsibilities include:

- Coordinating all bond issues for government corporations;
- Overseeing loans and credit lines to ensure prudent financial engineering, whereby government agencies, corporations, and instrumentalities can execute their development initiatives; and
- Structuring tax-free, private-sector investment options through a GDB affiliate, the Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (AFICA).

GDB's subsidiaries include:

- Puerto Rico Housing Finance Corp. (merged with the Puerto Rico Housing Bank in February 2002. The financing of housing projects is within one entity, the Puerto Rico Housing Finance Authority);

- Puerto Rico Development Fund;
- Puerto Rico Capital Fund;
- Puerto Rico Public Finance Corp; and
- Puerto Rico Tourism and Development Fund.

Also, GDB Puerto Rico affiliates include:

- Puerto Rico Municipal Finance Agency;
- Puerto Rico Infrastructure Financing Authority; and
- AFICA.

The Puerto Rico Housing Finance Agency is GDB's largest subsidiary; it has averaged 23% of consolidated assets and represents the majority of GDB bonds outstanding. The Housing Finance Corp. was created in 1977 to provide public and private housing developers with interim and permanent financing through mortgage loans for the construction, improvement, and operation of rental housing for low-to-moderate-income families. The Housing Finance Corp. is authorized by HUD to administer the U.S. Housing Section 8 program in Puerto Rico and to act as an approved mortgagee for both multifamily and rental units and single-family homes.

All balances and transactions of GDB's subsidiaries are consolidated with the bank's financial statements in accordance with GAAP. Although legally separate, the subsidiaries were created and can be dissolved through resolutions of the bank's board of directors. GDB's affiliates are created by law and can only be dissolved through legislation. The board of directors of each subsidiary is substantively the same as that of GDB.

GDB's President is appointed by Puerto Rico's governor, which can result in bank presidents frequently changing. Although GDB's board of directors provide some degree of continuity of governance and management, given the staggered terms, board members can also experience a high level of turnover when a new governor is elected.

Risk Management

Credit risk

Credit risk exposures are limited at GDB and concentrated to local government agencies, municipalities, and other public entities. GDB has never experienced a loss on a loan to a public entity. During the past few years, loans to public entities had steadily increased and reached a historic high of 63.85% of total assets, or $7.3 billion, as of June 30, 2006. The loan portfolio was $4.7 billion at Sept. 30, 2007. In fiscal 2007, GDB made a concerted effort to reduce its loan exposure to the commonwealth's government and lowered this exposure by nearly $2 billion at fiscal quarter ended Sept. 30, 2007. In July 2007, $1.7 billion of loans to the government were repaid using proceeds from the new sales tax, a 7% sales tax, and 1% was dedicated toward repaying pre-existing GDB loans to the commonwealth treasury. The sales tax proceeds are administered through the proceeds of a COFINA $4 billion, 'A+' rated appropriation bonds. Of GDB's loan portfolio, 25% ($1 billion) consists of pre-existing outstanding loans, the repayment of which is from dedicated sales tax proceeds. GDB is currently operating under a policy that will limit loans made directly to the government and will keep its loan portfolio below 50% of total assets. Also, as part of the commonwealth's fiscal reform package, a law was passed that prevents the government from borrowing from GDB for deficit financing purposes. The loan portfolio size of loans outstanding tends to peak at fiscal year-end June 30, and then immediately after the fiscal year end, loan pay-offs occur as agencies access the bond market to pay interim loans from GDB.

GDB also extends loans to public corporations and short-term liquidity lines (fed funds lines) to the local regulated banks in Puerto Rico.

The investment portfolio does not hold credit risk exposures because this portfolio is held to high credit quality and liquidity standards. The portfolio consists of high-quality government agencies and money market investments. The investment portfolio is currently 20% of total assets at Sept. 30, 2007, and cash and money market assets are a high 33% of total assets.

Liquidity risk

The funding profile has shifted at GDB during the past year, given the lowering of its credit ratings and the financial stress in the commonwealth. The most significant change has been the issuance of MTNs to replace CP for capital market funding, moving the average maturity from 90 days to more than three years. A total of $1.726 billion of notes are outstanding at Sept. 30, 2007, and CP usage is down to $626 million at Sept. 30, 2007. The maturity structure of the MTNs has been laddered out across a broad maturity range, reducing GDB's exposure to market risk. The deposit base provides a stable source of funds, which come from municipalities and other public entities; GDB competes for these funds with the public commercial banks in Puerto Rico. These deposits are primarily shorter term and have held steady in the 50%-51% range of total funding during the past year.

Profitability

Profitability measures have improved during the past year, despite GDB's higher funding costs. Profitability is still acceptable for the rating on a risk-adjusted basis and when considering the high cash balance and money market assets held. Revenue growth has benefited from a stronger net interest margin and the level of short-term rates, as the investment portfolio has a significant holding of high-quality money market investments. GDB has termed out its funding structure during the past year, replacing CP with MTNs, which has elevated its funding costs. Higher asset yields have helped to offset the effect on its spread from the increase in funding costs.

The higher operating expense base is a reflection of the inclusion of the Housing Finance Authority as part of GDB. The Housing Authority has a higher operating expense base, but also contributes a higher level of noninterest income to the revenue mix, all of which is associated with their Federal housing assistance programs. Also in fiscal 2008, nonrecurring charges associated with the early retirement packages offered to employees will elevate the expense base.

Capital

Capital continues to be a strength at GDB, and capital measures have improved during the past year. At Sept. 30, 2007, capital improved to 21% of total assets. Slower asset growth has aided the improvement in capital ratios, as well as no dividend payouts during the past three years. December 2004 was the last time a dividend was paid (the $1 billion payout to fund the Special Communities Trust), and at times there are some limited capital distributions associated with the business of the Housing Finance Agency. A small capital distribution, in the form of a dividend, is now eligible to be paid annually with the 2002 passage of Act 82. Certain legal restrictions prohibit the Commonwealth from extracting dividends or accessing the bank's capital base, ensuring a strong capital base will remain a part of GDB's credit profile. Nevertheless, the risk that special capital distributions will be authorized, similar to the commitment to the SPC Trust, remains.

Table 1

Balance Sheet Statistics

	--Year ended June 30--						Breakdown as a % of assets (adj.)					
(Mil. $)	**2008***	**2007**	**2006**	**2005**	**2004**	**2003**	**2008***	**2007**	**2006**	**2005**	**2004**	**2003**
Assets												
Cash and money market instruments	3,425	2,771	2,441	2,006	1,318	1,646	36.07	25.88	20.70	19.35	14.29	18.57
Securities	1,256	1,212	1,288	2,316	3,276	4,230	13.23	11.32	10.93	22.34	35.52	47.71
Nontrading securities	1,256	1,212	1,288	2,316	3,276	4,230	13.23	11.32	10.93	22.34	35.52	47.71
Customer loans (gross)	4,357	6,018	7,375	5,666	4,204	2,636	45.88	56.20	62.55	54.66	45.58	29.73
All other loans	4,357	6,018	7,375	5,666	4,204	2,636	45.88	56.20	62.55	54.66	45.58	29.73
Customer loans (net)	4,357	6,018	7,375	5,666	4,204	2,636	45.88	56.20	62.55	54.66	45.58	29.73
Earning assets	9,037	10,001	11,104	9,988	8,798	8,513	95.17	93.40	94.18	96.35	95.39	96.01
All other assets	458	707	686	378	425	354	4.83	6.60	5.82	3.65	4.61	3.99
Total reported assets	9,496	10,709	11,790	10,366	9,223	8,867	100.00	100.00	100.00	100.00	100.00	100.00
Adjusted assets	9,496	10,709	11,790	10,366	9,223	8,867	100.00	100.00	100.00	100.00	100.00	100.00
							Breakdown as a % of liabilities + equity					
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**	**2008***	**2007**	**2006**	**2005**	**2004**	**2003**
Liabilities												
Total deposits	4,800	5,770	6,784	4,873	3,813	3,537	50.55	53.88	57.54	47.01	41.34	39.88
Core/customer deposits	4,800	5,770	6,784	4,873	3,813	3,537	50.55	53.88	57.54	47.01	41.34	39.88
Repurchase agreements	480	455	N.A.	N.A.	N.A.	N.A.	5.05	4.25	N.A.	N.A.	N.A.	N.A.
Other borrowings	2,618	2,513	2,912	1,490	1,629	1,782	27.57	23.47	24.70	14.37	17.66	20.09
Other liabilities	179	580	793	2,041	1,465	1,393	1.89	5.42	6.72	19.69	15.88	15.71
Total liabilities	8,077	9,318	10,489	8,404	6,907	6,711	85.06	87.01	88.97	81.07	74.89	75.69
Total shareholders' equity	1,419	1,391	1,301	1,962	2,316	2,156	14.94	12.99	11.03	18.93	25.11	24.31
Common shareholders' equity (reported)	1,419	1,391	1,301	1,962	2,316	2,156	14.94	12.99	11.03	18.93	25.11	24.31
Other equity	1,419	1,391	1,301	1,962	2,316	2,156	14.94	12.99	11.03	18.93	25.11	24.31
Total liabilities and equity	9,496	10,709	11,790	10,366	9,223	8,867	100.00	100.00	100.00	100.00	100.00	100.00
Equity Reconciliation Table												
Common shareholders' equity (reported)	1,419	1,391	1,301	1,962	2,316	2,156						
Adjusted common equity	1,419	1,391	1,301	1,962	2,316	2,156						
Adjusted total equity	1,419	1,391	1,301	1,962	2,316	2,156						

*Data as of Sept. 30, 2008. Ratios annualized where appropriate. N.A.--Not available. Certain raw data items used within the above financial spreads have been obtained from SNL Financial LC.

Table 2

Profit And Loss Statement Statistics

	--Year ended June 30--						Adj. avg. assets (%)					
(Mil. $)	**2008***	**2007**	**2006**	**2005**	**2004**	**2003**	**2008***	**2007**	**2006**	**2005**	**2004**	**2003**
Profitability												
Interest income	139	566	551	422	371	391	5.52	5.03	4.98	4.31	4.10	4.46

Table 2

Profit And Loss Statement Statistics (cont.)												
Interest expense	110	438	429	258	190	213	4.35	3.90	3.87	2.63	2.10	2.43
Net interest income	30	128	122	164	181	178	1.17	1.13	1.10	1.68	2.00	2.03
Operating noninterest income	7	15	230	309	304	267	0.28	0.13	2.07	3.16	3.36	3.04
Other noninterest income	7	15	230	309	304	267	0.28	0.13	2.07	3.16	3.36	3.04
Operating revenues	37	143	352	474	485	445	1.45	1.27	3.17	4.84	5.36	5.07
Noninterest expenses	8	45	211	824	322	263	0.32	0.40	1.90	8.41	3.57	3.00
Personnel expenses	6	26	0	0	0	0	0.24	0.23	0.00	0.00	0.00	0.00
Other general and administrative expense	2	19	211	824	322	263	0.08	0.17	1.90	8.41	3.57	3.00
Net operating income before loss provisions	29	98	141	(350)	163	182	1.13	0.87	1.27	(3.58)	1.80	2.08
Credit loss provisions (net new)	0	2	6	4	2	1	0.00	0.02	0.06	0.04	0.03	0.01
Net operating income after loss provisions	29	95	134	(354)	160	181	1.13	0.85	1.21	(3.61)	1.77	2.06
Amortization of goodwill and intangibles	0	3	0	0	0	0	0.00	0.02	0.00	0.00	0.00	0.00
Pretax profit	29	93	134	(354)	160	181	1.13	0.82	1.21	(3.61)	1.77	2.06
Net income before minority interest	29	93	134	(354)	160	181	1.13	0.82	1.21	(3.61)	1.77	2.06
Net income before extraordinaries	29	93	134	(354)	160	181	1.13	0.82	1.21	(3.61)	1.77	2.06
Net income after extraordinaries	29	93	134	(354)	160	181	1.13	0.82	1.21	(3.61)	1.77	2.06
Core Earnings Reconciliation												
Net income (before minority interest)	29	93	134	(354)	160	181						
+ Amortization/impairment of goodwill/intangibles	0	3	0	0	0	0						
Core earnings	29	95	134	(354)	160	181						
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**						
Asset Quality												
Average balance sheet												
Average customer loans	5,187	6,696	6,520	4,935	3,420	2,433						
Average earning assets	9,519	10,553	10,546	9,393	8,655	7,603						
Average assets	10,102	11,249	11,078	9,794	9,045	8,772						
Average total deposits	5,285	6,277	5,828	4,343	3,675	3,702						
Average interest-bearing liabilities	8,318	9,217	8,029	5,902	5,380	5,342						
Average common equity	1,405	1,346	1,632	2,139	2,236	N.A.						
Average adjusted assets	10,102	11,249	11,078	9,794	9,045	8,772						

*Data as of Sept. 30, 2008. Ratios annualized where appropriate. N.A.--Not available. Certain raw data items used within the above financial spreads have been obtained from SNL Financial LC.

Table 3

Ratio Analysis						
		--Year ended June 30--				
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**
ANNUAL GROWTH (%)						
Customer loans (gross)	(110.42)	(18.40)	30.16	34.78	59.46	18.24
Adjusted assets	(45.30)	(9.17)	13.74	12.40	4.01	2.20
Customer deposits	(67.24)	(14.95)	39.23	27.79	7.81	(8.57)

Table 3

Ratio Analysis (cont.)						
Total equity	8.06	6.88	(33.69)	(15.28)	7.44	N.M.
Operating revenues	2.70	(59.42)	(25.78)	(2.38)	9.06	(11.48)
Noninterest expense	(27.66)	(78.75)	(74.39)	155.49	22.68	(7.61)
Net operating income before provisions	16.61	(30.40)	N.M.	(315.11)	(10.60)	(16.52)
Loan-loss provisions	(99.68)	(60.78)	66.16	57.26	90.12	205.76
Net operating income after provisions	19.64	(28.97)	N.M.	(320.74)	(11.31)	(16.95)
Pretax profit	23.05	(30.94)	N.M.	(320.74)	(11.31)	(16.95)
Net income	23.05	(30.94)	N.M.	(320.74)	(11.31)	(16.95)
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**
PROFITABILITY (%)						
Interest Margin Analysis						
Net interest income (taxable equiv.)/avg. earning assets	1.24	1.21	1.16	1.75	2.09	2.35
Net interest spread	0.58	0.61	(0.12)	0.13	0.76	1.16
Interest income (taxable equiv.)/avg. earning assets	5.85	5.36	5.23	4.49	4.29	5.15
Interest income on loans/avg. total loans	5.66	5.55	5.33	5.09	6.32	5.46
Interest expense/avg. interest-bearing liabilities	5.28	4.75	5.35	4.37	3.53	3.99
Interest expense on deposits/avg. deposits	5.56	4.82	0.00	0.00	0.00	0.00
REVENUE ANALYSIS						
Net interest income/revenues	80.75	89.39	34.70	34.69	37.33	40.09
Noninterest income/revenues	19.25	10.61	65.30	65.31	62.67	59.91
Personnel expense/revenues	16.45	18.35	0.00	0.00	0.00	0.00
Noninterest expense/revenues	22.13	31.42	60.01	173.92	66.45	59.08
Noninterest expense/revenues less investment gains	22.13	31.42	60.01	173.92	66.45	59.08
Net operating income before provision/revenues	77.87	68.58	39.99	(73.92)	33.55	40.92
Net operating income after provisions/revenues	77.86	66.84	38.19	(74.72)	33.05	40.64
New loan-loss provisions/revenues	0.01	1.74	1.80	0.80	0.50	0.29
Pretax profit/revenues	77.86	64.99	38.19	(74.72)	33.05	40.64
Core earnings/revenues	77.86	66.84	38.19	(74.72)	33.05	40.64
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**
OTHER RETURNS						
Net operating income before LLP/LLP	1426400.00	3939.49	2219.89	(9185.70)	6715.43	14280.78
Net income before minority interest/avg. adjusted assets	1.13	0.82	1.21	(3.61)	1.77	2.06
Noninterest expenses/average adjusted assets	0.32	0.40	1.90	8.41	3.57	3.00
Cash earnings/avg. tang. common equity (ROE) (%)	8.12	7.09	8.23	(16.55)	7.17	N.A.
Core earnings/average adjusted assets	1.13	0.85	1.21	(3.61)	1.77	2.06
Core earnings/average ACE (ROE)	8.12	7.09	8.23	(16.55)	7.17	16.77
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**
FUNDING AND LIQUIDITY (%)						
Customer deposits/funding base	60.78	66.03	69.97	76.58	70.07	66.50
Total loans/customer deposits	90.77	104.30	108.71	116.28	110.25	74.54
Total loans/customer deposits + long-term funds	70.06	84.05	91.21	82.90	68.59	46.31

Table 3

Ratio Analysis (cont.)						
Customer loans (net)/assets (adj.)	45.88	56.20	62.55	54.66	45.58	29.73
Parent-Only Analysis						
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**
CAPITALIZATION (%)						
Internal capital generation/prior year's equity	8.21	7.13	6.84	(15.28)	7.44	N.M.
Adjusted total equity/adjusted assets	14.94	12.99	11.03	18.93	25.11	24.31
Adjusted total equity/adjusted assets + securitizations	14.94	12.99	11.03	18.93	25.11	24.31
Adjusted total equity plus LLR (specific)/customer loans (gross)	32.56	23.11	17.64	34.63	55.10	81.77
	2008*	**2007**	**2006**	**2005**	**2004**	**2003**
ASSET QUALITY (%)						
New loan-loss provisions/avg. customer loans (net)	0.00	0.04	0.10	0.08	0.07	0.05

*Data as of Sept. 30, 2008. Ratios annualized where appropriate. N.A.--Not available. N.M.--Not meaningful. Certain raw data items used within the above financial spreads have been obtained from SNL Financial LC.

Ratings Detail (As Of December 21, 2007)*	
Government Development Bank for Puerto Rico	
Counterparty Credit Rating	BBB/Stable/A-2
Certificate Of Deposit	
Local Currency	BBB/A-2
Commercial Paper	
Local Currency	A-2
Senior Unsecured	
Local Currency	BBB
Counterparty Credit Ratings History	
13-Dec-2007	BBB/Stable/A-2
22-May-2007	BBB-/Stable/A-3
21-Jul-2006	BBB/Negative/A-2
22-Mar-2006	BBB/Watch Neg/A-2
21-Oct-2005	BBB/Negative/A-2
24-May-2005	BBB+/Negative/A-2
11-Jan-2005	A/Negative/A-1
Sovereign Rating	
United States of America	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.