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LLM&D, PSC
165 Ponce de León Ave.,
Second Floor
San Juan, Puerto Rico
00917-1233

PUERTO RICO MUNICIPAL FINANCE AGENCY

(A Component Unit of the Commonwealth of Puerto Rico)

BASIC FINANCIAL STATEMENTS,
SUPPLEMENTARY INFORMATION
AND
REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2013

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS AND TAX CONSULTANTS
Member Firm of The American Institute and the Puerto Rico Society of Certified Public Accountants

Tel. 787.777.0660 • Fax. 787.765.8033 • www.llmdcpa.com

PUERTO RICO MUNICIPAL FINANCE AGENCY
(A Component Unit of the Commonwealth of Puerto Rico)

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Puerto Rico Municipal Finance Agency

Report on the Financial Statements

We have audited the accompanying statement of net position of the Puerto Rico Municipal Finance Agency (the "Agency") as of June 30, 2013 and the statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the Agency'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 basic financial statements in accordance with accounting principles generally accepted in the United States of America; 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.

Auditor's Responsibility

Our responsibility is to express opinions on these basic 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 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 auditor's 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 Agency'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 Agency'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 opinion.

Opinion

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Agency, as of June 30, 2013, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in note 1, in 2013, the Agency adopted Governmental Accounting Standards Board ("GASB") Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position.* Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the Agency's basic financial statements as a whole. The Schedule I – Investments Held by Trustees by Bond Series, on pages 23 through 24 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

LLM&D, PSC

San Juan, PR
February 4, 2014

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Society of Certified Public Accountants
was affixed to the record copy of this report

This section represents the management's discussion and analysis of the Puerto Rico Municipal Finance Agency (the "Agency") financial performance for the fiscal year ended June 30, 2013, and is presented as a narrative overview and analysis in conjunction with the basic financial statements.

The Agency was created to assist municipalities of Puerto Rico in financing their public improvements programs. The Agency's activities consist of servicing its bond obligations and disbursing escrow deposits arising from the acquisition of investments in Puerto Rico municipal bonds and notes from the Government Development Bank for Puerto Rico (the "Bank"). Escrow liabilities to municipalities are undisbursed loan deposits directly related to the municipal public improvement projects. These deposits are disbursed based on the municipalities' necessities. The balance of the escrow liabilities to municipalities is reduced with the disbursements made for each related project and is increased with the acquisition of Puerto Rico municipal bonds and notes.

1. Financial Highlights

- At June 30, 2013, the Agency's total assets and net position were approximately $1,056 million and $70 million, respectively.
- During the fiscal year ended June 30, 2013, bonds principal payments and escrow liability to municipalities disbursements amounted to approximately $93.8 million and $7.2 million, respectively.
- The fair value of the Agency's investments portfolio decreased by approximately $5.3 million during the year ended June 30, 2013.
- Investment income for the year ended June 30, 2013 decreased by approximately $11.6 million.

2. Financial Statements Overview

The financial statements include the management's discussion and analysis section, the independent auditors' report, and the basic financial statements of the Agency. The notes to the basic financial statements explain in more detail some of the information in the financial statements.

3. Required Financial Statements

The financial statements of the Agency are prepared using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about the activities of the Agency. The statement of net position presents the Agency's assets and liabilities, providing information about the nature and amount of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the Agency and assessing its liquidity and financial flexibility.

Revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures the success of the Agency's operations over the past year, and can be used to determine whether the Agency has successfully recovered its costs from the revenues it has 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 non-capital financing activities and provides answers to such questions as where did cash came from, what was cash used for, and what was the change in the cash balance during the reporting period.

4. Financial Analysis

Net position may serve, overtime, as a useful indicator of whether a governmental entity's financial position is improving or deteriorating. At June 30, 2013, the Agency's total assets exceeded total liabilities by approximately $70.1 million, representing an increment of approximately $471 thousands over prior year net position of approximately $69.6 million.

Condensed financial information of the Agency's assets, liabilities, operating revenues, operating expenses and change in net position is as follows (in thousands):

	June 30,		Change	
	2013	2012	Amount	Percent
Current assets	$ 264,180	$ 270,045	$ (5,865)	-2.17%
Other assets	792,750	892,280	(99,530)	-11.15%
Total assets	1,056,930	1,162,325	(105,395)	-9.07%
Current liabilities	176,401	177,872	(1,471)	-0.83%
Noncurrent liabilities	810,472	914,867	(104,395)	-11.41%
Total liabilities	986,873	1,092,739	(105,866)	-9.69%
Investment income	45,606	57,161	(11,555)	-20.21%
Interest and other expenses	45,135	50,127	(4,992)	-9.96%
Change in net position	471	7,034	(6,563)	-93.30%
Net position, beginning of year	69,586	62,552	7,034	11.25%
Net position, end of year	$ 70,057	$ 69,586	$ 471	0.68%

Total assets and liabilities decreased approximately $105 million and $106 million, respectively, when compared with prior year. This reduction is associated with the current year debt repayment of approximately $93.8 million and the disbursement of escrow liabilities to municipalities of approximately $7.2 million.

Investment income decreased approximately $11.6 million mainly due to the following:

- During the year ended June 30, 2013 there was an unrealized loss of approximately $5.3 million on the fair value of investments when compared to an unrealized gain of approximately $1.3 million during the year ended June 30, 2012 that had a net effect decreasing investment income by approximately $6.6 million in 2013.
- Decrease in interest income of approximately $4.9 million during the year ended June 30, 2013 when compared to the year ended June 30, 2012. The reduction in interest income is due to the decrease in the investment portfolio during the year.

Interest and other expenses decreased approximately $5 million during the year ended June 30, 2013, mainly due to a reduction in interest expense on bonds payable of approximately $4.9 million.

5. Debt Administration

At June 30, 2013, outstanding bonds of the Agency amounted to approximately $908 million, including its current portion of approximately $101.5 million. Debt repayments amounted to approximately $93.8 million during the year ended June 30, 2013.

6. Request for Information

This financial report is designed to provide all interested parties with a general overview of the Agency's finances and to facilitate the Agency's accountability for the resources it managers. If you have questions about this report or need additional information, contact the Puerto Rico Municipal Finance Agency, PO Box 42001, San Juan, Puerto Rico, 00940-2001.

PUERTO RICO MUNICIPAL FINANCE AGENCY
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET POSITION
JUNE 30, 2013

ASSETS	
CURRENT ASSETS:	
Cash	$ 2,847,464
Other	43,213
Restricted:	
Cash	7,658,551
Accrued interest receivable	23,122,236
Investments	230,508,561
Total current assets	264,180,025
NONCURRENT RESTRICTED ASSETS:	
Investments	782,619,124
Deferred bond issue costs	10,130,656
Total noncurrent restricted assets	792,749,780
Total assets	$ 1,056,929,805
LIABILITIES	
CURRENT LIABILITIES:	
Accrued expenses and other liabilities	$ 560,645
Escrow liability to municipalities	55,098,706
Total current liabilities	55,659,351
CURRENT LIABILITIES FROM RESTRICTED ASSETS:	
Accrued interest payable	19,161,022
Bonds payable	101,580,000
Total current liabilities from restricted assets	120,741,022
NONCURRENT LIABILITIES FROM RESTRICTED ASSETS:	
Due to an affiliated entity	3,521,173
Bonds payable, net	806,951,127
Total noncurrent liabilities from restricted assets	810,472,300
Total liabilities	986,872,673
NET POSITION:	
Restricted	122,825,806
Unrestricted deficit	(52,768,674)
Total net position	$ 70,057,132

See notes to basic financial statements.

PUERTO RICO MUNICIPAL FINANCE AGENCY
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2013

INVESTMENT INCOME:	
Interest and dividend income	$ 50,873,571
Unrealized loss on changes in fair value of investments	(5,267,125)
Total operating and investment income	45,606,446
INTEREST EXPENSE	44,958,403
NET INVESTMENT INCOME	648,043
NON-INVESTMENT EXPENSES:	
Management fees	48,000
Other	128,894
Total non-interest expenses	176,894
OPERATING INCOME AND CHANGE IN NET POSITION	471,149
NET POSITION, beginning of year	69,585,983
NET POSITION, end of year	$ 70,057,132

See notes to basic financial statements.

PUERTO RICO MUNICIPAL FINANCE AGENCY
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2013

CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash paid for general and administrative expenses	$ (183,514)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Payments of bonds payable	(93,835,000)
Interest paid on bonds payable	(47,703,192)
Payments of escrow liability to municipalities	(7,153,527)
Payments to affiliated entity	(2,464)
Net cash used in non-capital financing activities	(148,694,183)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of investment securities	(227,642,579)
Proceeds from sales and redemptions of investment securities	232,012,073
Proceeds from sales and redemptions of municipal bonds and notes	90,357,005
Collections of interest income	51,216,101
Proceeds from sales and redemptions of other investments	6,550,838
Net cash provided by investing activities	152,493,438
NET INCREASE IN CASH	3,615,741
CASH - Beginning of year	6,890,274
CASH - End of year	$ 10,506,015
RECONCILIATION OF CASH AT END OF YEAR TO STATEMENT OF NET POSITION:	
Unrestricted cash	$ 2,847,464
Restricted cash	7,658,551
TOTAL CASH AT END OF YEAR	$ 10,506,015

See notes to basic financial statements. (Continued)

PUERTO RICO MUNICIPAL FINANCE AGENCY
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2013

RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating income	$	471,149
Adjustments to reconcile operating income to net cash used in operating activities:		
Investment income		(45,606,446)
Interest expense		44,958,403
Changes in assets and liabilities:		
Increase in other assets		(11,250)
Increase in accrued expenses and other liabilities		4,630
Net cash used in operating activities	$	(183,514)

See notes to basic financial statements. (Concluded)

1. REPORTING ENTITY

The Puerto Rico Municipal Finance Agency (the "Agency") is a component unit of the Commonwealth of Puerto Rico (the "Commonwealth"), created by Act 29 of the Legislature of the Commonwealth on June 30, 1972, as amended, (the "Act 29-1972") and an affiliate of Government Development Bank for Puerto Rico (the "Bank").

The Agency was created to assist municipalities of Puerto Rico in financing their public improvements programs. The Agency's activities consist of servicing its bond obligations and disbursing escrow deposits arising from the acquisition of investments in Puerto Rico municipal bonds and notes from the Bank. Escrow liabilities to municipalities are undisbursed loan funds which use is restricted to specific municipal public improvement projects. These deposits are disbursed based on the municipalities' necessities. The balance of the escrow liabilities to municipalities is reduced with the disbursements made for each related project and is increased with the acquisition of Puerto Rico municipal bonds and notes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Agency conform to Accounting Principles Generally Accepted in the United States of America ("GAAP"), for governments as prescribed by the Governmental Accounting Standards Board ("GASB").

Effective July 1, 2012, the Agency adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* This statement provides financial reporting guidance for deferred outflows of resources, which are consumptions of net position by the government that is applicable to a future reporting period and deferred inflows of resources which are acquisitions of net position by the government that is applicable to a future reporting period. Statement No. 63 amends the net asset reporting requirements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The adoption of Statement No. 63 resulted in a change in the presentation of the Statement of Net Assets to what is now referred to as the Statement of Net Position and the term "net assets" is changed to "net position" throughout the basic financial statements. The Agency had no deferred outflows or deferred inflows of resources as permitted by Statement No. 63, at June 30, 2013.

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

Measurement Focus, Basis of Accounting and Financial Statements Presentation - The Agency'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. Net investment income is the excess of amounts earned by the Agency on its interest-earning assets over the interest incurred on its interest-bearing liabilities. The Agency's net investment income is subject to interest rate risk due to the re-pricing and maturity relationship of the Agency's assets and liabilities. Revenues and expenses not meeting these criteria are reported as non-interest income and expenses.

The statement of net position presents the Agency's assets and liabilities, with the difference reported as net position. Net position is reported in two categories:

(a) Restricted component of net position consists of restricted assets reduced by liabilities related to those assets. Restricted net position result when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

(b) Unrestricted component of net position consists of net amount of the assets and liabilities that do not meet the definition of the preceding category. Unrestricted component of net position often is designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted component of net position often has constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of revenues, expenses, and changes in net position demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include: (1) interest income investments. Operating expenses are those that relate to the administration of the Agency. Other items not meeting the definition of program revenues or operating expense are reported as non-operating revenues or expenses.

Income Tax - The Agency is exempt from taxation in Puerto Rico.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investments - Investments and investment contracts are carried at fair value, except for money market investments and participating investment contracts with a remaining maturity at the time of purchase of one year or less, and non-participating investment contracts, which are carried at cost. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations, except for investments in Puerto Rico municipal bonds and notes. Puerto Rico municipal bonds and notes fair values are estimated by management based on quoted market prices for the debt these investments collateralize. Such quoted market prices are obtained from independent sources.

Except for investments in Puerto Rico municipal bonds and notes, and bonds payable, the carrying values of the Agency's financial instruments are substantially similar to their fair value at June 30, 2013, because such instruments have either short-term maturities or bear interest at rates that vary with the market. The fair value of the Agency's bonds payable is estimated using quoted market prices from independent sources.

Deferred Bond Issue Costs - Bond issue costs are deferred and amortized as a component of interest expenses over the term of the related debt using effective interest method or systematic and rational method that approximate effective interest method.

Refunding - Refunding involves the issuance of new debt which proceeds are used to repay immediately (current refunding), or at a future time (advance refunding), previously issued debt. The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life or the new debt, whichever is shorter. The deferred amount is reported on the statement of net assets as an addition to or deduction from the new debt.

Recently Issued Accounting Guidance:

The GASB has issued the following accounting pronouncements that have effective date after June 30, 2013:

(a) GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities, or viceversa. In the case of the Agency, most of the impact will remain in the statement of net position; except for its existing deferred debt issue costs of approximately $10.1 million at June 30, 2013, which will require elimination against beginning net position upon adoption; and prospectively, new debt issue costs on bonds or debt issuance will require to be recognized as an expense in the period incurred. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.

(b) GASB Statement No. 66, *Technical Corrections 2012*. The objective of this Statement, among other provisions, is to amend Statement No. 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. No impact is expected upon the adoption of this statement on January 1, 2013.

(c) GASB Statement No. 67, *Financial Reporting for Pension Plans — an amendment of GASB Statement No. 25*. The objective of this Statement is to improve financial reporting by state and local governmental pension plans. The major fundamental change, among others related to the application and determination of certain measurement assumptions in valuing pension plans, is switching from the existing "funding-based" accounting model, where currently the Annual Required Contribution ("ARC") is compared to the actual payments made and that difference determines the Net Pension Obligation; to an "accrual basis" model similar to current Financial Accounting Standard Board ("FASB") standards, where the Total Pension Obligation (Actuarially determined) is compared to the Net Plan Position and the difference represents the Net Pension Liability. This particular Statement will not be applicable to the Agency, as the Agency does not have its own pension plan; on the other hand, this will be applicable to the three Employees' Retirement Systems of the Commonwealth (the "Retirement Systems"). However, this change applicable to only the Retirement Systems will have an impact on the different government agencies and public corporations, including the Agency, when GASB Statement No. 68, discussed below, is adopted effective for fiscal year 2015. The provisions of this Statement are effective for the financial statements of the Retirement Systems for periods beginning after June 15, 2013.

(d) GASB Statement No. 68, *Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27.* This Statement, among other requirements, will bring the effect of Statement 67 summarized above, into the accounting records of the individual agencies, public corporations and municipalities, whose employees participate in the Retirement Systems. The Agency, as well as the other component units of the Commonwealth and the municipalities, are considered "cost-sharing" employers of the Retirement Systems; therefore, a government participating in the Retirement Systems, such as the Agency, would report the resulting Net Pension Liability from Statement 67 as follows:

- ✓ Based on the Agency's proportion of the collective net pension liability of all the governments participating
- ✓ The proportion should be consistent with the method used to assess contributions (percentage of payroll).

The impact of the effects of this Statement on the Agency's basic financial statements is not expected to be significant as the Agency currently has no employees participating in Retirement Systems. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014.

(e) GASB Statement No. 69, *Government Combinations and Disposals of Government Operations.* This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations include a variety of transactions referred to as mergers, acquisitions, and transfer of operations. The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis.

(f) GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This Statement requires a governmental entity guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. Certain qualitative factors should be considered when evaluating the likelihood of a guaranty payment, such as: initiation of a bankruptcy process, breach of a debt contract in relation to the guaranteed obligation and indications of significant financial difficulty to pay agents or trustees. This Statement is not expected to have any impact on the Agency as the Agency has no financial guarantees outstanding at December 31, 2012. This Statement is effective for financial statements for periods beginning after June 15, 2013.

3. CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that, in the event of the failure of a depository financial institution, the Agency will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. Currently, the Agency does not have a custodial credit risk policy. At June 30, 2013, the Agency's cash balance includes approximately $3 million interest-bearing demand deposits with the Bank, which is not covered by federal depository insurance. Such demand deposits are uninsured and uncollateralized.

The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance ($250,000 at June 30, 2013). At June 30, 2013, all securities pledged by depository institutions as collateral are held by a trustee of the Treasury Department of the Commonwealth. At June 30, 2013, the Agency maintained approximately $7.6 million as restricted cash in a trustee escrow account with a financial institution, which is insured and collateralized, for purposes of servicing the outstanding debt.

4. TRANSACTIONS WITH GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

The Bank provides certain services to the Agency and charges a management fee under a management contract. During the year ended June 30, 2013, the Bank charged $48,000 as management fee to the Agency. At June 30, 2013, the balance due to the Bank is approximately $3.5 million.

5. INVESTMENTS

The Bank developed investment guidelines for the Government of Puerto Rico and their respective agencies and instrumentalities under the Act 113 of August 3, 1995 and Executive Order 1995-50A (the "Investment Guidelines"). Accordingly with such Investment Guidelines, the Agency is authorized to purchase or enter into the following investment instruments:

- United States (U.S) government, agencies, and sponsored agencies obligations
- Certificates of Deposit
- Bankers' acceptances
- Commercial paper
- Participations in the Puerto Rico Government Investment Trust Fund
- Obligations of the Commonwealth of Puerto Rico, its agencies, municipalities, public corporations and instrumentalities
- Obligations of state and local government of the U.S.
- Mortgage and asset-backed securities
- Corporate debt, including investment contracts
- External investment pools

The Investment Guidelines establish restrictions for investment instruments, such as maturities, investment limits, issuer or counterparty, exposure by country, and defines eligible financial institutions.

Such Investment Guidelines, which were adopted by the Agency, provide that only counterparties rated BBB+/A-1 or better by Standard & Poor's or equivalent ratings by Moody's Investors Service or Fitch Ratings are used to enter into investment transactions. These guidelines also provide that investment purchases and sales need to be executed using the delivery versus payment method. Any exception from these guidelines must be approved by the Agency's board of directors.

At June 30, 2013, restricted investment securities held by trustees for repayment of bond issuances and other liabilities consist of the following (in thousands):

	Amount
Puerto Rico municipal bonds and notes	$ 839,517
External investment pool	58,588
Guaranteed investment contracts	36,708
Corporate bonds	33,353
Money Market	30,709
Mortgage and asset-backed securities	14,253
	$ 1,013,128

At June 30, 2013, contractual maturities by investment securities consist of the following (in thousands):

	Contractual Maturities (in thousands)				
	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	Total
Puerto Rico municipal bonds and notes	$ 93,606	$ 308,254	$ 260,698	$ 176,959	$ 839,517
External investment pool	58,588	-	-	-	58,588
Guaranteed investment contract	-	-	15,863	20,845	36,708
Corporate bonds	33,353	-	-	-	33,353
Money Market	30,709				30,709
Mortgage and asset-backed securities	14,253	-	-	-	14,253
	$ 230,509	$ 308,254	$ 276,561	$ 197,804	$ 1,013,128

Fixed income securities from external investment pools mature within 60 days or less. Such securities are presented as investment with expected maturity within one year or less. Expected maturities differ from contractual maturities when issuers or counterparties have the right-to-call or prepay such obligations with or without call or prepayment penalties.

At June 30, 2013, the credit ratings of the investment securities portfolio are as follows (in thousands):

	Credit Rate Risk (dollars in thousands)		
	AAA to A	BBB-	Total
Puerto Rico municipal bonds and notes	$ -	$ 839,517	$ 839,517
External investment pool	58,588	-	58,588
Guaranteed investments contracts		36,708	36,708
Corporate bonds	33,353	-	33,353
Money Market	30,709		30,709
Mortgage and asset-backed securities	8,959	5,294	14,253
	$ 131,609	$ 881,519	$ 1,013,128

As required by the indentures and the Act 29-1972, the municipal bonds and notes are general obligations of each municipal issuer secured by *ad valorem* taxation, without limitation as to rate or amount, on all taxable property within the boundaries of the applicable municipal issuer. The good faith, credit and unlimited taxing power of each issuing municipality are pledged for the payment of its general obligations municipal bonds and notes. Interest rate on general obligations municipal bonds and notes range from 4.36% to 8.21%.

6. BONDS PAYABLE

At June 30, 2013, bonds payable consist of the following:

	Interest Rate	Amount	Due within One Year
1997 Series A Bonds maturing on July 1, 2013.	6%	$ 10,895,000	$ 10,895,000
1999 Series B Bonds maturing on August 1, 2013.	5.75%	7,970,000	7,970,000
2002 Series A Bonds, including unamortized premium of $4,002,887, maturing at various dates through August 1, 2027.	4.75% - 5.25%	295,047,887	25,165,000
2005 Series A, B, and C Bonds, including unamortized premium of $16,516,777 and deferred loss on refunding of $6,568,537, maturing at various dates through August 1, 2030.	3.80% - 5.25%	594,618,240	57,550,000
		$ 908,531,127	$ 101,580,000

At June 30, 2013, debt services requirements for outstanding bonds are as follow:

Year Ending June 30,	Principal	Interest	Total
2014	$ 101,580,000	$ 42,666,289	$ 144,246,289
2015	83,335,000	38,040,850	121,375,850
2016	84,765,000	33,962,865	118,727,865
2017	83,375,000	29,826,560	113,201,560
2018	71,145,000	25,858,166	97,003,166
2019-2023	273,785,000	81,341,344	355,126,344
2024-2028	137,955,000	27,324,025	165,279,025
2029-2031	58,640,000	7,321,544	65,961,544
	894,580,000	$ 286,341,643	$ 1,180,921,643
Plus/(less):			
Unamortized premium	20,519,664		
Unamortized deferred loss on refunding of bonds	(6,568,537)		
	$ 908,531,127		

Bonds activity for the year ended June 30, 2013 is as follows:

	Balance at June 30, 2012	Issuances	Other Increases	Other Reductions	Payments	Balances at June 30, 2013
Bonds payable	$ 988,415,000	$ -	$ -	$ -	$ (93,835,000)	$ 894,580,000
Plus/(less):						
Unamortized premium	25,338,546	-	-	(4,818,882)	-	20,519,664
Unamortized deferred loss on refunding on bonds	(8,574,919)	-	2,006,382	-	-	(6,568,537)
	$ 1,005,178,627	$ -	$ 2,006,382	$ (4,818,882)	$ (93,835,000)	$ 908,531,127

The 2002 Series A Bonds, maturing after August 1, 2012, may be redeemed at the option of the Agency, upon not less than 30 days prior notice, either in whole or in part, as directed by the Agency. The bonds may be redeemed not earlier than August 1, 2012 at a redemption price equal to the principal amount to be redeemed, together with accrued interest thereon, and without premium. The 2005 Series A Bonds, Series B, and C Refunding Bonds were issued on December 22, 2005. The 2005 Series A Bonds and Series C Refunding bonds maturing on or after August 1, 2015 may be redeemed prior to their maturity, at the option of the Agency, upon not less than 30 days prior notice at a redemption price equal to the principal amount to be redeemed plus accrued interest at par.

The 2005 Series A Bonds maturing on August 1, 2030 with principal amounts of $58,025,000 and $615,000, respectively, are subject to redemption to the extent of the respective amortization requirements, upon not less than 30 days prior notice to registered owners starting on August 1, 2026 and thereafter at a redemption price equal to the principal amount to be redeemed plus accrued interest. The 2005 Series A Bonds amortization requirements are as follows:

Amortization Requirements for
2005 Series A Bonds Maturing on August 1,

Year		
2026	$ 14,085,000	$ 145,000
2027	16,335,000	165,000
2028	13,685,000	140,000
2029	7,885,000	95,000
2030	6,035,000	70,000
	$ 58,025,000	$ 615,000

The 2005 Series B Refunding Bonds are not subject to redemption. The bonds issued were used, together with other moneys, to refund some of the outstanding 1997 Series A Bonds. The reacquisition price exceeded the net carrying amount of the old debt by approximately $3.5 million. The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of the interest expense over the remaining life of the old debt or the life of the net debt, whichever is shorter. The deferred amount is reported on the accompanying statement of net position as an addition to or reduction from the debt.

The 2005 Series C Refunding Bonds were used, together with other moneys, to refund some of the outstanding 1999 Series A Bonds and 1999 Series B Refunding Bonds. The reacquisition price exceeded the net carrying amount of the old debt by approximately $15.9 million. The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of the interest expense over the remaining life of the old debt or the life of the net debt, whichever is shorter. The deferred amount is reported on the accompanying statement of net position as an addition to or reduction from the debt.

At June 30, 2013, approximately $298.9 million of refunded bonds remain outstanding.

7. DEBT SERVICE RESERVE FUND

The provisions of Act 29-1972 established a Debt Service Reserve Fund (the "Reserve Fund"). The Agency invests the monies maintained in Reserve Funds in U.S. government, agencies and sponsored agencies securities, external investment pools, and investment agreements. Such investments are presented as restricted investments in the accompanying statement of net position. The Agency is authorized and may request advances, as needed, from the Bank to cover any shortage in the Reserve Fund required level. No such advances were requested during the year ended June 30, 2013.

The 1997 Reserve Fund requires an amount equal to the lesser of (i) ten percent (10%) of the original proceeds of each series of 1997 indenture bonds outstanding , (ii) the maximum annual principal and interest requirements for any fiscal year on all 1997 indenture bonds outstanding, and (iii) 125% of average annual debt service on all 1997 indenture bonds outstanding. Pursuant to 1997 indenture bonds, the required reserve is approximately $10 million. At June 30, 2013, the Agency maintains approximately $17 million in the 1997 Reserve Fund.

The Agency is required to maintain in the 1999 Reserve Fund an amount equal to the sum of (i) the higher of (a) 50% of the maximum principal and interest payments requirements for any fiscal year on all 1999 indenture bonds then outstanding and (b) the largest amount of the maximum principal and interest payments requirement for any fiscal year on the 1999 municipal bonds of any 1999 municipal issuer, and (ii) 50% of the annual earnings for such fiscal year on the larger of the amounts in clauses (a) and (b) above based on the assumption that said amount is invested in investment instrument in accordance with the United States Internal Revenue Code of 1986, as amended. Pursuant to the 1999 indenture bonds, the required reserve is approximately $33 million. At June 30, 2013, the Agency maintains approximately $33 million in the 1999 Reserve Fund.

The 2002 Reserve Fund requires an amount equal to the sum of (i) the higher of (a) 50% of the maximum principal and interest payments requirements for any fiscal year on all 2002 indenture bonds then outstanding and (b) the largest amount of the maximum principal and interest payments requirement for any fiscal year on the 2002 municipal bonds of any 2002 municipal issuer, and (ii) 50% of the annual earnings for such fiscal year on the larger of the amounts in clauses (a) and (b) above based on the assumption that said amount is invested in investment instrument in accordance with the United States Internal Revenue Code of 1986, as amended. Pursuant to the 2002 indenture bonds, the required reserve is approximately $14 million. At June 30, 2013, the Agency maintains approximately $21 million in the 2002 Reserve Fund.

The 2005 Reserve Fund requires an amount equal to the sum of (i) the higher of (a) 50% of the maximum principal and interest payments requirements for any fiscal year on all 2005 indenture bonds then outstanding and (b) the largest amount of the maximum principal and interest payments requirement for any fiscal year on the 2005 municipal bonds of any 2005 municipal issuer, and (ii) 50% of the annual earnings for such fiscal year on the larger of the amounts in clauses (a) and (b) above based on the assumption that said amount is invested in investment instrument in accordance with the United States Internal Revenue Code of 1986, as amended. Pursuant to the 2005 indenture bonds, the required reserve is approximately $17 million. At June 30, 2013, the Agency maintains approximately $17 million in the 2005 Reserve Fund.

8. SUBSEQUENT EVENTS

During the month of February 2014, various credit rating agencies lowered the credit rating on the Agency's bonds payable to non-investment grade. These credit rating agencies cited their evaluation of the Commonwealth of Puerto Rico's liquidity as the reason for the decrease in credit rating. As a result of this event, management of the Agency has evaluated the Agency's capacity to timely comply with the debt service requirements of its bonds payable.

As previously disclosed in the Note 5, the Agency has approximately $1,013 million in investment securities which are restricted for the debt service payment as disclose on Note 6. Management believes its investment securities portfolio, as a readily marketable investment, provides a strong liquidity source to support debt service requirements on its bonds payable on a timely basis.

For the year ended June 30, 2013, subsequent events were evaluated through February 4, 2014, 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 other than those already disclosed above, there are no material events or transactions that would affect the Agency's financial statements through such date.

SUPPLEMENTAL SCHEDULE

PUERTO RICO MUNICIPAL FINANCE AGENCY
(A Component Unit of the Commonwealth of Puerto Rico)
SCHEDULE I – INVESTMENTS HELD BY TRUSTEES BY BOND SERIES
AS OF JUNE 30, 2013

	2005 Series A, B and C Bonds	2002 Series A Bonds	1999 Series A and B Bonds	1997 Series A and B Bonds	Total
Puerto Rico municipal bonds and notes	$ 282,078,205	271,796,525	$ 224,531,654	$ 61,110,134	$ 839,516,518
External investment pool	15,307,889	18,363,826	24,915,666	-	58,587,381
Guaranteed investment contracts	-	20,844,838	-	15,863,142	36,707,980
Corporate bonds	-	-	33,353,156	-	33,353,156
Money Market	18,157,253	-	12,552,108	-	30,709,361
Mortgage and asset-backed securities	2,722,583	3,417,953	6,236,624	1,876,129	14,253,289
Total invesments	$ 318,265,930	$ 314,423,142	$ 301,589,208	$ 78,849,405	$ 1,013,127,685
Cash	$ 24,341	$ 3,970,065	$ -	$ 3,664,145	$ 7,658,551