

FIRST BANCORP /PR/  
Form 10-Q  
November 10, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

---

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2014

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 001-14793

**First BanCorp.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

<b>Puerto Rico</b> <b>(State or other jurisdiction of</b>	<b>66-0561882</b> <b>(I.R.S. employer</b>
<b>incorporation or organization)</b>	<b>identification number)</b>
<b>1519 Ponce de León Avenue, Stop 23</b>	<b>00908</b>
<b>Santurce, Puerto Rico</b>	<b>(Zip Code)</b>
<b>(Address of principal executive offices)</b>	
<b>(787) 729-8200</b>	
<b>(Registrant's telephone number, including area code)</b>	
<b>Not applicable</b>	
<b>(Former name, former address and former fiscal year, if changed since last report)</b>	

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

x

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock: 213,004,449 shares outstanding as of October 31, 2014.

---

**FIRST BANCORP.**

**INDEX PAGE**

<b>PART I FINANCIAL INFORMATION</b>	<b>PAGE</b>
Item 1. Financial Statements:	
Consolidated Statements of Financial Condition (Unaudited) as of September 30, 2014 and December 31, 2013	5
Consolidated Statements of Income (Loss) (Unaudited) – Quarters ended September 30, 2014 and 2013 and nine-month periods ended September 30, 2014 and 2013	6
Consolidated Statements of Comprehensive Income (Loss) (Unaudited) – Quarters ended September 30, 2014 and 2013 and nine-month periods ended September 30, 2014 and 2013	7
Consolidated Statements of Cash Flows (Unaudited) – Nine-month periods ended September 30, 2014 and 2013	8
Consolidated Statements of Changes in Stockholders’ Equity (Unaudited) – Nine-month periods ended September 30, 2014 and 2013	9
Notes to Consolidated Financial Statements (Unaudited)	10
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	84
Item 3. Quantitative and Qualitative Disclosures About Market Risk	160
Item 4. Controls and Procedures	160
<b>PART II. OTHER INFORMATION</b>	
Item 1. Legal Proceedings	161
Item 1A. Risk Factors	161
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	164
Item 3. Defaults Upon Senior Securities	165
Item 4. Mine Safety Disclosures	165
Item 5. Other Information	165
Item 6. Exhibits	165

**SIGNATURES**

### Forward Looking Statements

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to the safe harbor created by such sections. When used in this Form 10-Q or future filings by First BanCorp. (the "Corporation") with the U.S. Securities and Exchange Commission ("SEC"), in the Corporation's press releases or in other public or stockholder communications, or in oral statements made with the approval of an authorized executive officer, the word or phrases "would be," "will allow," "intends to," "will likely result," "are expected to," "should," "anticipate" and other of similar meaning or import in connection with any discussion of future operating, financial or other performance are meant to identify "forward-looking statements."

First BanCorp. wishes to caution readers not to place undue reliance on any such "forward-looking statements," which speak only as of the date made, and to advise readers that various factors, including, but not limited to, the following, could cause actual results to differ materially from those expressed in, or implied by, such "forward-looking statements":

- uncertainty about whether the Corporation and FirstBank Puerto Rico ("FirstBank" or "the Bank") will be able to fully comply with the written agreement dated June 3, 2010 (the "Written Agreement") that the Corporation entered into with the Federal Reserve Bank of New York (the "New York FED" or "Federal Reserve") and the consent order dated June 2, 2010 (the "FDIC Order") and together with the Written Agreement, (the "Agreements") that the Corporation's banking subsidiary, FirstBank, entered into with the Federal Deposit Insurance Corporation ("FDIC") and the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico ("OCIF") that, among other things, require the Bank to maintain certain capital levels and reduce its special mention, classified, delinquent and non-performing assets;
- the risk of being subject to possible additional regulatory actions;
- uncertainty as to the availability of certain funding sources, such as retail brokered certificates of deposit ("brokered CDs");
- the Corporation's reliance on brokered CDs and its ability to obtain, on a periodic basis, approval from the FDIC to issue brokered CDs to fund operations and provide liquidity in accordance with the terms of the FDIC Order;

- the risk of not being able to fulfill the Corporation's cash obligations or resume paying dividends to the Corporation's stockholders in the future due to the Corporation's need to receive approval from the New York FED and the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") to receive dividends from FirstBank or FirstBank's failure to generate sufficient cash flow to make a dividend payment to the Corporation;
- the strength or weakness of the real estate markets and of the consumer and commercial credit sectors and their impact on the credit quality of the Corporation's loans and other assets, which has contributed and may continue to contribute to, among other things, high levels of non-performing assets, charge-offs and provisions and may subject the Corporation to further risk from loan defaults and foreclosures;
- the ability of FirstBank to realize the benefit of its deferred tax asset;

- adverse changes in general economic conditions in Puerto Rico, the United States (“U.S.”) and the U.S. Virgin Islands (“USVI”), and British Virgin Islands (“BVI”), including the interest rate environment, market liquidity, housing absorption rates, real estate prices, and disruptions in the U.S. capital markets, which may reduce interest margins, impact funding sources, and affect demand for all of the Corporation’s products and services and reduce the Corporation’s revenues and earnings, and the value of the Corporation’s assets;
- a credit default by the Puerto Rico government or any of its public corporations or other instrumentalities, and recent and any future downgrades of the long-term and short-term debt ratings of the Puerto Rico government, which could exacerbate Puerto Rico’s adverse economic conditions;
- an adverse change in the Corporation’s ability to attract new clients and retain existing ones;
- a decrease in demand for the Corporation’s products and services and lower revenues and earnings because of the continued recession in Puerto Rico, the current fiscal problems of the Puerto Rico government and recent credit downgrades of the Puerto Rico government’s debt;
- the risk that any portion of the unrealized losses in the Corporation’s investment portfolio is determined to be other-than-temporary, including unrealized losses on the Puerto Rico government’s obligations;
- uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the U.S., the USVI, and the BVI, which could affect the Corporation’s financial condition or performance and could cause the Corporation’s actual results for future periods to differ materially from prior results and anticipated or projected results;
- changes in the fiscal and monetary policies and regulations of the U.S. federal government, including those determined by the Federal Reserve Board, the New York FED, the FDIC, government-sponsored housing agencies, and regulators in Puerto Rico, the USVI and the BVI;
- the risk of possible failure or circumvention of controls and procedures and the risk that the Corporation’s risk management policies may not be adequate;

- the risk that the FDIC may increase the deposit insurance premium and/or require special assessments to replenish its insurance fund, causing an additional increase in the Corporation's non-interest expenses;
- the impact on the Corporation's results of operations and financial condition of acquisitions and dispositions;
- a need to recognize impairments on financial instruments, goodwill or other intangible assets relating to acquisitions;
- the risk that downgrades in the credit ratings of the Corporation's long-term senior debt will adversely affect the Corporation's ability to access necessary external funds;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") on the Corporation's businesses, business practices and cost of operations; and
- general competitive factors and industry consolidation.

The Corporation does not undertake, and specifically disclaims any obligation, to update any "forward-looking statements" to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by the federal securities laws.

Investors should refer to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013, as well as "Part II, Item 1A, Risk Factors" in this quarterly report on Form 10-Q, for a discussion of such factors and certain risks and uncertainties to which the Corporation is subject.



**FIRST BANCORP.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**(Unaudited)**

	September 30, 2014		December 31, 2013	
(In thousands, except for share information)				
<b>ASSETS</b>				
Cash and due from banks	\$	953,038	\$	454,302
Money market investments:				
Time deposits with other financial institutions		300		300
Other short-term investments		16,657		201,069
Total money market investments		16,957		201,369
Investment securities available for sale, at fair value:				
Securities pledged that can be repledged		1,032,467		1,042,482
Other investment securities		944,670		935,800
Total investment securities available for sale		1,977,137		1,978,282
Other equity securities		25,752		28,691
Investment in unconsolidated entity		-		7,279
Loans, net of allowance for loan and lease losses of \$225,434				
(2013 - \$285,858)		9,089,968		9,350,312
Loans held for sale, at lower of cost or market		80,014		75,969
Total loans, net		9,169,982		9,426,281
Premises and equipment, net		167,916		166,946
Other real estate owned		112,803		160,193
Accrued interest receivable on loans and investments		48,516		54,012
Other assets		171,179		179,570
Total assets	\$	12,643,280	\$	12,656,925
<b>LIABILITIES</b>				
Non-interest-bearing deposits	\$	862,422	\$	851,212
Interest-bearing deposits		8,840,752		9,028,712
Total deposits		9,703,174		9,879,924
Securities sold under agreements to repurchase		900,000		900,000
Advances from the Federal Home Loan Bank (FHLB)		325,000		300,000
Other borrowings		231,959		231,959
Accounts payable and other liabilities		158,990		129,184
Total liabilities		11,319,123		11,441,067

<b>STOCKHOLDERS' EQUITY</b>					
Preferred stock, authorized, 50,000,000 shares:					
Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000					
shares, outstanding 1,444,146 shares (2013 - 2,521,872 shares outstanding),					
aggregate liquidation value of \$36,104 (2013 - \$63,047)		36,104			63,047
Common stock, \$0.10 par value, authorized, 2,000,000,000 shares;					
issued, 213,642,311 shares (2013 - 207,635,157 shares issued)		21,364			20,764
Less: Treasury stock (at par value)		(66)			(57)
Common stock outstanding, 212,977,588 shares outstanding (2013 - 207,068,978					
shares outstanding)		21,298			20,707
Additional paid-in capital		915,231			888,161
Retained earnings		385,847			322,679
Accumulated other comprehensive loss, net of tax of \$7,752		(34,323)			(78,736)
Total stockholders' equity		1,324,157			1,215,858
Total liabilities and stockholders' equity	\$	12,643,280		\$	12,656,925
The accompanying notes are an integral part of these statements.					

## FIRST BANCORP.

## CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(Unaudited)

	Quarter Ended				Nine-Month Period Ended			
	September 30,				September 30,			
	2014		2013		2014		2013	
(In thousands, except per share information)								
<b>Interest and dividend income:</b>								
Loans	\$	144,295	\$	147,325	\$	433,379	\$	443,954
Investment securities		11,894		14,422		40,850		37,650
Money market investments		473		456		1,427		1,494
Total interest income		156,662		162,203		475,656		483,098
<b>Interest expense:</b>								
Deposits		19,344		21,453		59,109		70,915
Securities sold under agreements to repurchase		6,857		6,531		19,655		19,418
Advances from FHLB		949		1,524		2,606		5,180
Other borrowings		1,818		1,790		5,365		5,299
Total interest expense		28,968		31,298		86,735		100,812
Net interest income		127,694		130,905		388,921		382,286
<b>Provision for loan and lease losses</b>		26,999		22,195		85,658		220,782
Net interest income after provision for loan and lease losses		100,695		108,710		303,263		161,504
<b>Non-interest income (loss):</b>								
Service charges on deposit accounts		3,235		3,157		9,728		9,635
Mortgage banking activities		3,809		3,521		10,213		12,924
Net gain (loss) on sale of investments (includes \$42 accumulated other comprehensive income reclassification for other-than-temporary impairment on equity securities for the nine-month period ended September 30, 2013)		-		-		291		(42)
Other-than-temporary impairment losses on available-for-sale debt securities:								
Total other-than-temporary impairment losses		-		-		-		-

Portion of other-than-temporary impairment losses previously										
recognized in other comprehensive income		(245)			-		(245)			(117)
Net impairment losses on available-for-sale debt securities		(245)			-		(245)			(117)
Equity in loss of unconsolidated entity		-			(5,908)		(7,280)			(10,798)
Impairment of collateral pledged to Lehman		-			-		-			(66,574)
Insurance commission income		1,290			1,303		5,328			4,831
Other non-interest income		8,085			7,987		25,420			22,167
Total non-interest income (loss)		16,174			10,060		43,455			(27,974)
<b>Non-interest expenses:</b>										
Employees' compensation and benefits		33,964			32,823		101,929			99,493
Occupancy and equipment		14,727			15,109		43,527			45,062
Business promotion		3,925			3,538		12,040			10,726
Professional fees		11,533			11,840		32,944			36,707
Taxes, other than income taxes		4,528			4,718		13,607			14,009
Insurance and supervisory fees		9,493			11,513		31,267			37,018
Net loss on other real estate owned (OREO) and OREO operations		4,326			7,052		16,941			29,191
Credit and debit card processing expenses		3,741			2,682		11,447			8,040
Communications		2,143			1,866		5,916			5,565
Other non-interest expenses		5,224			8,013		14,916			22,676
Total non-interest expenses		93,604			99,154		284,534			308,487
<b>Income (loss) before income taxes</b>		23,265			19,616		62,184			(174,957)
<b>Income tax expense</b>		(64)			(3,676)		(675)			(4,319)
<b>Net income (loss)</b>	\$	23,201	\$	15,940	\$	61,509	\$	(179,276)		
<b>Net income (loss) attributable to common stockholders</b>	\$	23,201	\$	15,940	\$	63,168	\$	(179,276)		
<b>Net earnings (loss) per common share:</b>										
Basic	\$	0.11	\$	0.08	\$	0.30	\$	(0.87)		
Diluted	\$	0.11	\$	0.08	\$	0.30	\$	(0.87)		
<b>Dividends declared per common share</b>	\$	-	\$	-	\$	-	\$	-		

The accompanying notes are an integral part of these statements.

## FIRST BANCORP.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Quarter Ended				Nine-Month Period Ended			
	September 30, 2014		September 30, 2013		September 30, 2014		September 30, 2013	
(In thousands)								
Net income (loss)	\$	23,201	\$	15,940	\$	61,509	\$	(179,276)
Available-for-sale debt securities on which an other-than-temporary impairment has been recognized:								
Subsequent unrealized gain on debt securities on which an other-than-temporary impairment has been recognized		104		1,304		1,291		2,739
Reclassification adjustment for other-than-temporary impairment on debt securities included in net income		245		-		245		117
All other unrealized holding gains (losses) on available-for-sale securities:								
All other unrealized holding (losses) gains arising during the period		(6,265)		(20,061)		43,168		(89,807)
Reclassification adjustments for net gain included in net income		-		-		(291)		-
Reclassification adjustment for other-than-temporary impairment on equity securities		-		-		-		42
Income tax benefit (expense) related to items of other comprehensive income		-		414		-		(8)
Other comprehensive (loss) income for the period, net of tax		(5,916)		(18,343)		44,413		(86,917)
Total comprehensive income (loss)	\$	17,285	\$	(2,403)	\$	105,922	\$	(266,193)
The accompanying notes are an integral part of these statements.								



## FIRST BANCORP.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine-Month Period Ended			
	September 30,		September 30,	
	2014		2013	
(In thousands)				
<b>Cash flows from operating activities:</b>				
Net income (loss)	\$	61,509	\$	(179,276)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation		15,604		17,911
Amortization of intangible assets		3,723		4,558
Provision for loan and lease losses		85,658		220,782
Deferred income tax benefit		(2,815)		(2,577)
Stock-based compensation		2,962		2,088
Gain on sales of investments, net		(291)		-
Other-than-temporary impairments on debt securities		245		117
Other-than-temporary impairments on equity securities		-		42
Equity in loss of unconsolidated entity		7,280		10,798
Impairment of collateral pledged to Lehman		-		66,574
Derivative instruments and financial liabilities measured at fair value, gain		(820)		(762)
Loss (gain) on sales of premises and equipment and other assets		20		(4)
Net gain on sales of loans		(5,498)		(6,253)
Net amortization of premiums, discounts and deferred loan fees and costs		(1,966)		(3,248)
Originations and purchases of loans held for sale		(223,602)		(400,614)
Sales and repayments of loans held for sale		234,698		461,510
Loans held for sale valuation adjustment		-		6,553
Amortization of broker placement fees		5,140		6,094
Net amortization of premium and discounts on investment securities		3,348		7,473
Increase in accrued income tax payable		2,847		1,130
Decrease in accrued interest receivable		5,496		1,823
Increase in accrued interest payable		4,620		1,345
Decrease in other assets		25,536		22,400
Increase in other liabilities		13,206		24,076
Net cash provided by operating activities		236,900		262,540
<b>Cash flows from investing activities:</b>				

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Principal collected on loans		2,533,504			2,081,371
Loans originated and purchased		(2,410,182)			(2,362,492)
Proceeds from sales of loans held for investment		31,558			309,024
Proceeds from sales of repossessed assets		51,399			70,805
Proceeds from sales of available-for-sale securities		4,855			-
Purchases of available-for-sale securities		(133,596)			(690,377)
Proceeds from principal repayments and maturities of available-for-sale securities		171,016			280,694
Additions to premises and equipment		(17,863)			(8,919)
Proceeds from sale of premises and equipment and other assets		1,269			4
Net redemptions/sales of other equity securities		2,939			6,661
Net cash provided by (used in) investing activities		234,899			(313,229)
<b>Cash flows from financing activities:</b>					
Net (decrease) increase in deposits		(181,890)			83,557
Net FHLB advances proceeds (paid)		25,000			(155,000)
Repurchase of outstanding common stock		(523)			(335)
Issuance costs of common stock issued in exchange for preferred stock Series A through E		(62)			-
Net cash used in financing activities		(157,475)			(71,778)
Net increase (decrease) in cash and cash equivalents		314,324			(122,467)
Cash and cash equivalents at beginning of period		655,671			946,851
Cash and cash equivalents at end of period	\$	969,995		\$	824,384
Cash and cash equivalents include:					
Cash and due from banks	\$	953,038		\$	623,019
Money market instruments		16,957			201,365
	\$	969,995		\$	824,384
The accompanying notes are an integral part of these statements.					



## FIRST BANCORP.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

	Nine-Month Period Ended			
	September 30,		September 30,	
	2014		2013	
(In thousands)				
<b>Preferred Stock</b>				
Balance at beginning of period	\$	63,047	\$	63,047
Exchange of preferred stock- Series A through E		(26,943)		-
Balance at end of period		36,104		63,047
<b>Common Stock outstanding:</b>				
Balance at beginning of period		20,707		20,624
Common stock issued as compensation		23		15
Common stock withheld for taxes		(10)		(5)
Common stock issued in exchange for Series A through E preferred stock		459		-
Restricted stock grants		122		74
Restricted stock forfeited		(3)		(4)
Balance at end of period		21,298		20,704
<b>Additional Paid-In-Capital:</b>				
Balance at beginning of period		888,161		885,754
Stock-based compensation		2,962		2,088
Common stock withheld for taxes		(513)		(335)
Common stock issued in exchange for Series A through E preferred stock		23,904		-
Reversal of issuance costs of Series A through E preferred stock exchanged		921		-
Issuance costs of common stock issued in exchange for Series A through E preferred stock		(62)		-
Restricted stock grants		(122)		(74)
Common stock issued as compensation		(23)		-
Restricted stock forfeited		3		4
Balance at end of period		915,231		887,437
<b>Retained Earnings:</b>				
Balance at beginning of period		322,679		487,166
Net income (loss)		61,509		(179,276)

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Excess of carrying amount of Series A through E preferred stock exchanged over fair value of new					
shares of common stock		1,659			-
Balance at end of period		385,847			307,890
<b>Accumulated Other Comprehensive Income (Loss), net of tax:</b>					
Balance at beginning of period		(78,736)			28,432
Other comprehensive income (loss), net of tax		44,413			(86,917)
Balance at end of period		(34,323)			(58,485)
Total stockholders' equity	\$	1,324,157		\$	1,220,593
The accompanying notes are an integral part of these statements.					

**FIRST BANCORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

The Consolidated Financial Statements (unaudited) of First BanCorp. (“the Corporation”) have been prepared in conformity with the accounting policies stated in the Corporation’s Audited Consolidated Financial Statements included in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2013. Certain information and note disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements of the Corporation for the year ended December 31, 2013, which are included in the Corporation’s 2013 Annual Report on Form 10-K. All adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the quarter and nine-month period ended September 30, 2014 are not necessarily indicative of the results to be expected for the entire year.

**Adoption of new accounting requirements and recently issued but not yet effective accounting requirements**

The Financial Accounting Standards Board (“FASB”) has issued the following accounting pronouncements and guidance relevant to the Corporation’s operations:

In July 2013, the FASB updated the Codification to provide explicit guidelines on how to present an unrecognized tax benefit in financial statements when a net operating loss (“NOL”) carryforward, a similar tax loss, or a tax credit carryforward exists. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle

any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments are effective for public entities with fiscal periods beginning after December 15, 2013. The adoption of this guidance in 2014 did not have an effect on the Corporation's financial statements as the Corporation's NOLs and tax credit carryforwards are not available to settle any additional income taxes that would result from the disallowance of the Corporation's unrecognized tax benefits. Refer to Note 18 for additional information about the Corporation's unrecognized tax benefits, including the settlement reached with the United States Internal Revenue Service ("IRS") in the third quarter of 2014.

In January 2014, the FASB updated the Codification to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan so that the loan should be derecognized and the real estate property recognized in the financial statements. The Update clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. In addition, creditors are required to disclose on an annual and interim basis both (i) the amount of the foreclosed residential real estate property held and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

The amendments are effective for public business entities for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 31, 2015. Early adoption is permitted. The guidance can be implemented using either a modified retrospective transition method or a prospective transition method. The Corporation is currently evaluating the impact of the adoption of this guidance on its financial statements.

In April 2014, the FASB issued an update to current accounting standards which will change the criteria for reporting discontinued operations. The amendments will also require new disclosures about discontinued operations and disposals of components of an entity that do not qualify for discontinued operations reporting. The amendments are effective for the Corporation for new disposals (or classifications as held for sale) of components of the Corporation, should they occur, beginning in the first quarter of fiscal year 2016. Early adoption is permitted for disposals (or classifications as held for sale) that have not been previously reported.

In May 2014, the FASB updated the Codification to create a new, principle-based revenue recognition framework. The Update is the culmination of efforts by the FASB and the International Accounting Standards Board to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance describes a 5-step process entities can apply to achieve the core principle of revenue recognition and requires disclosures sufficient to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers and the significant judgments used in determining that information. The amendments are effective for public business entities for annual periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Corporation is currently evaluating the impact that the adoption of this guidance will have on the presentation and disclosures in its financial statements.

In June 2014, the FASB updated the Codification to respond to stakeholders' concerns about current accounting and disclosures for repurchase agreements and similar transactions. This Update requires two accounting changes. First, the Update changes the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the Update requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. Additionally, the Update introduces new disclosures to (i) increase transparency about the types of collateral pledged in secured borrowing transactions and (ii) enable users to better understand transactions in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. For public business entities, the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. All other accounting and disclosure amendments in the Update are effective for public business entities for the first interim or annual period beginning after December 15, 2014. The Corporation is currently evaluating the impact that the adoption of this guidance will have on the presentation and disclosures in its financial statements, if any.

In June 2014, the FASB updated the Codification to provide guidance for determining compensation cost under specific circumstances when an employee's compensation award is eligible to vest regardless of whether the employee is rendering service on the date the performance target is achieved. This Update becomes effective for annual and interim periods beginning after December 15, 2015 with early adoption permitted. The Update is effective for all business entities for annual periods and interim periods within those annual periods beginning after December 15, 2015. The Corporation is currently evaluating the impact that the adoption of this guidance will have on the presentation and disclosures in its financial statements, if any.

In August 2014, the FASB updated the Codification to reduce the diversity found in the classification of certain foreclosed mortgage loans held by creditors that are either fully or partially guaranteed under government programs. Consistency in classification upon foreclosure is expected in order to provide more decision-useful information. The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if: (i) the loan has a government guarantee that is not separable from the loan before foreclosure; (ii) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under the claim, and (iii) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The Update is effective for public business entities for annual periods, and interim periods within those annual periods beginning after December 15, 2014. The guidance can be implemented using either a prospective transition method or a modified retrospective transition method. The Corporation is currently evaluating the impact that the adoption of this guidance will have on the presentation and disclosures in its financial statements.

In August 2014, the FASB updated the Codification to provide guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued. If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, but the substantial doubt is alleviated as a result of consideration of management's plans, the entity should disclose information that enables users of the financial statements to understand. The Update is effective for all business entities for annual periods ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Corporation expects the adoption of this guidance will have no impact on the Corporation's financial position, results of operations, comprehensive income, cash flows and disclosures.

**NOTE 2 – EARNINGS PER COMMON SHARE**

The calculations of earnings (losses) per common share for the quarters and nine month periods ended September 30, 2014 and 2013 are as follows:										
	Quarter Ended					Nine-Month Period Ended				
	September 30,					September 30,				
	2014		2013			2014		2013		
(In thousands, except per share information)										
Net income (loss)	\$	23,201	\$	15,940	\$	61,509	\$	(179,276)		
Favorable impact from issuing common stock in exchange for Series A through E preferred stock		-		-		1,659		-		
Net income (loss) attributable to common stockholders	\$	23,201	\$	15,940	\$	63,168	\$	(179,276)		
<b>Weighted-Average Shares:</b>										
Basic weighted-average common shares outstanding		210,466		205,579		208,151		205,512		
Average potential common shares		1,893		1,737		1,660		-		
Diluted weighted-average number of common shares outstanding		212,359		207,316		209,811		205,512		
<b>Earnings (loss) per common share:</b>										
Basic	\$	0.11	\$	0.08	\$	0.30	\$	(0.87)		
Diluted	\$	0.11	\$	0.08	\$	0.30	\$	(0.87)		

Earnings (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares issued and outstanding. Net income (loss) attributable to common stockholders represents net income (loss) adjusted for any preferred stock dividends, including any dividends declared, and any cumulative dividends related to the current dividend period that have not been declared as of the end of the period. For the nine-month period ended September 30, 2014, net income attributable to common stockholders also includes the one-time effect to retained earnings of the issuance of common stock in exchange for Series A through E preferred stock. These transactions are discussed in Note 17 to the unaudited consolidated financial statements. Basic weighted average common shares outstanding excludes unvested shares of restricted stock.



Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect on earnings per share. Stock options not included in the computation of outstanding shares because they were antidilutive amounted to 82,575 and 104,499 for the quarters and nine-month periods ended September 30, 2014 and 2013, respectively. Warrants outstanding to purchase 1,285,899 shares of common stock and 1,435,220 unvested shares of restricted stock were excluded from the computation of diluted earnings per share for the nine-month period ended September 30, 2013 because the Corporation reported a net loss attributable to common stockholders for the period and their inclusion would have an antidilutive effect.

**NOTE 3 – STOCK-BASED COMPENSATION**

Between 1997 and January 2007, the Corporation had the 1997 stock option plan that authorized the granting of up to 579,740 options on shares of the Corporation’s common stock to eligible employees. The options granted under the plan could not exceed 20% of the number of common shares outstanding.

On January 21, 2007, the 1997 stock option plan expired; all outstanding awards granted under this plan continue in full force and effect, subject to their original terms. No awards for shares could be granted under the 1997 stock option plan as of its expiration.

The activity of stock options granted under the 1997 stock option plan for the nine-month period ended September 30, 2014 is set forth below:								
						<b>Weighted-Average</b>		
						<b>Remaining</b>		<b>Aggregate</b>
	<b>Number of</b>		<b>Weighted-Average</b>		<b>Contractual Term</b>			<b>Intrinsic Value</b>
	<b>Options</b>		<b>Exercise Price</b>		<b>(Years)</b>			<b>(In thousands)</b>
Beginning of period outstanding and exercisable	101,435	\$	206.95					
Options expired	(12,795)		321.75					
Options cancelled	(6,065)		226.15					
End of period outstanding and exercisable	82,575	\$	187.75		1.6		\$	-

On April 29, 2008, the Corporation’s stockholders approved the First BanCorp. 2008 Omnibus Incentive Plan, as amended (the “Omnibus Plan”). The Omnibus Plan provides for equity-based compensation incentives (the “awards”) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. The Omnibus Plan authorizes the issuance of up to 8,169,807 shares of common stock, subject to adjustments for stock splits, reorganizations and other similar events. The Corporation’s Board of Directors, upon receiving the relevant recommendation of the Compensation Committee, has the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards, subject to various limits and vesting restrictions that apply to individual and aggregate awards.

Under the Omnibus Plan, during the first nine months of 2014, 379,573 shares of restricted stock were awarded to the Corporation's independent directors subject to vesting periods that range from 1 to 5 years. In addition, during the first nine months of 2014, the Corporation issued 840,138 shares of restricted stock that will vest based on the employees' continued service with the Corporation. Fifty percent (50%) of those shares vest in two years from the grant date and the remaining 50% vest in three years from the grant date. Included in those 840,138 shares of restricted stock are 653,138 shares granted to certain senior officers consistent with the requirements of the Troubled Asset Relief Program ("TARP") Interim Final Rule, which permit TARP recipients to grant "long-term restricted stock" without violating the prohibition on paying or accruing a bonus payment if it satisfies the following requirements: (i) the value of the grant may not exceed one-third of the amount of the employee's annual compensation, (ii) no portion of the grant may vest before two years after the grant date, and (iii) the grant must be subject to a further restriction on transfer or payment as described below. Specifically, the stock that has otherwise vested may not become transferable at any time earlier than as permitted under the schedule set forth by TARP, which is based on the repayment in 25% increments of the aggregate financial assistance received from the U.S. Department of Treasury (the "Treasury"). Hence, notwithstanding the vesting period mentioned above, the employees covered by TARP are restricted from transferring the shares.

The fair value of the shares of restricted stock granted in 2014 was based on the market price of the Corporation's outstanding common stock on the date of the grant. For the 653,138 shares of restricted stock granted under the TARP requirements, the market price was discounted due to postvesting restrictions. For purposes of computing the discount, the Corporation estimated an appreciation of 16% in the value of the common stock using the Capital Asset Pricing Model as a basis of what would be a market participant's expected return on the Corporation's stock and assumed that the Treasury would hold its outstanding common stock of the Corporation for two years, resulting in a fair value of \$2.63 for restricted shares granted under the TARP requirements. Also, the Corporation uses empirical data to estimate employee termination; separate groups of employees that have similar historical exercise behavior were considered separately for valuation purposes.

The following table summarizes the restricted stock activity in 2014 under the Omnibus Plan for both executive officers covered by the TARP requirements and other employees as well as for independent directors:				
<b>Nine-Month Period Ended</b>				
<b>September 30, 2014</b>				
	<b>Number of shares of restricted stock</b>			<b>Weighted-Average Grant Date Fair Value</b>
Non-vested shares at beginning of year	1,411,185		\$	3.04
Granted	1,219,711			3.75
Forfeited	(33,840)			3.20
Vested	(119,838)			4.76
Non-vested shares at September 30, 2014	2,477,218		\$	3.32

For the quarter and nine-month period ended September 30, 2014, the Corporation recognized \$0.6 million and \$1.8 million, respectively, of stock-based compensation expense related to restricted stock awards, compared to \$0.5 million and \$1.1 million for the same periods in 2013. As of September 30, 2014, there was \$4.7 million of total unrecognized compensation cost related to nonvested shares of restricted stock. The weighted average period over which the Corporation expects to recognize such cost is 2.2 years.

During the third quarter of 2013, 22,218 shares of restricted stock were awarded to the Corporation's independent directors subject to a one-year vesting period. In addition, during the first nine months of 2013, the Corporation issued 716,405 shares of restricted stock that will vest based on the employees' continued service with the Corporation. Fifty percent (50%) of those shares vest in two years from the grant date and the remaining 50% vest in three years from the grant date. Included in those 716,405 shares of restricted stock are 582,905 shares granted to certain senior officers consistent with the requirements of TARP. The employees covered by TARP are restricted from transferring the shares, subject to certain conditions as explained above.

The fair value of the shares of restricted stock granted in the first nine months of 2013 was based on the market price of the Corporation's outstanding common stock on the date of the grant. For the 582,905 shares of restricted stock granted under the TARP requirements, the market price was discounted due to postvesting restrictions. For purposes of computing the discount, the Corporation assumed appreciation of 13% in the value of the common stock and a holding period by the Treasury of its outstanding common stock of the Corporation of two years, resulting in a fair value of \$3.02 for restricted shares granted under the TARP requirements.

Stock-based compensation accounting guidance requires the Corporation to develop an estimate of the number of share-based awards that will be forfeited due to employee or director turnover. Quarterly changes in the estimated forfeiture rate may have a significant effect on share-based compensation, as the effect of adjusting the rate for all expense amortization is recognized in the period in which the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease in the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase in the expense recognized in the financial statements. When unvested options or shares of restricted stock are forfeited, any compensation expense previously recognized on the forfeited awards is reversed in the period of the forfeiture. Approximately \$65 thousand of compensation expense was reversed during the first nine months of 2014 related to forfeited awards.

Also, under the Omnibus Plan, effective April 1, 2013, the Corporation's Board of Directors determined to increase the salary amounts paid to certain executive officers primarily by paying the increased salary amounts in the form of shares of the Corporation's common stock, instead of cash. During the first nine months of 2014, the Corporation issued 224,162 shares of common stock with a weighted average market value of \$5.21 as salary stock compensation. This resulted in a compensation expense of \$1.2 million recorded in the first nine-months of 2014.

For the first nine-months of 2014, the Corporation withheld 74,989 shares from the common stock paid to certain senior officers as additional compensation and 23,555 shares of restricted stock that vested during the first quarter of 2014, to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury shares. The Corporation paid any fractional share of salary stock that the officer was entitled to in cash. In the consolidated financial statements, the Corporation treats shares withheld for tax purposes as common stock repurchases.

**NOTE 4 – INVESTMENT SECURITIES***Investment Securities Available for Sale*

The amortized cost, non-credit loss component of other-than-temporary impairment (“OTTI”) recorded in other comprehensive income (“OCI”), gross unrealized gains and losses recorded in OCI, approximate fair value, weighted average yield and contractual maturities of investment securities available for sale as of September 30, 2014 and December 31, 2013 were as follows:

		September 30, 2014									
		Amortized cost	Noncredit Loss Component of OTTI Recorded in OCI	Gross Unrealized				Fair value	Weighted average yield %		
				gains	losses						
(Dollars in thousands)											
U.S. Treasury securities:											
	Due within one year	\$ 7,496	\$ -	\$ 2	\$ -	\$ 7,498	0.11				
Obligations of U.S. government-sponsored agencies:											
	After 1 to 5 years	174,161	-	1	4,225	169,937	1.18				
	After 5 to 10 years	133,121	-	9	4,538	128,592	1.52				
Puerto Rico government obligations:											
	After 1 to 5 years	39,816	-	-	10,006	29,810	4.49				
	After 5 to 10 years	885	-	1	-	886	5.20				
	After 10 years	20,446	-	-	4,753	15,693	5.83				

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

United States and Puerto Rico													
government obligations	375,925		-		13		23,522			352,416		1.89	
Mortgage-backed securities:													
FHLMC certificates:													
After 10 years	325,487		-		860		4,265			322,082		2.19	
GNMA certificates:													
After 1 to 5 years	49		-		1		-			50		3.34	
After 5 to 10 years	1,534		-		84		-			1,618		3.28	
After 10 years	375,148		-		20,387		-			395,535		3.83	
	376,731		-		20,472		-			397,203		3.83	
FNMA certificates:													
After 1 to 5 years	4,639		-		201		-			4,840		3.44	
After 5 to 10 years	9,640		-		467		15			10,092		3.49	
After 10 years	862,358		-		5,736		13,720			854,374		2.36	
	876,637		-		6,404		13,735			869,306		2.38	
Other mortgage pass-through													
trust certificates:													
Over 5 to 10 years	115		-		1		-			116		7.27	
After 10 years	48,774		12,774		-		-			36,000		2.17	
	48,889		12,774		1		-			36,116		2.17	
Total mortgage-backed securities	1,627,744		12,774		27,737		18,000			1,624,707		2.67	
Equity securities (without contractual maturity) (1)	35		-		-		21			14		-	
Total investment securities available for sale	\$ 2,003,704		\$ 12,774		\$ 27,750		\$ 41,543			\$ 1,977,137		2.52	

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

(1) Represents common shares of another financial institution in Puerto Rico.															



		December 31, 2013									
		Amortized cost	Noncredit Loss Component of OTTI Recorded in OCI	Gross Unrealized				Fair value	Weighted average yield %		
				gains	losses						
U.S. Treasury securities:											
	Due within one year	\$ 7,498	\$ -	\$ 1	\$ -		\$ 7,499	0.12			
Obligations of U.S. government-sponsored agencies:											
	After 1 to 5 years	50,000	-	-	1,408		48,592	1.05			
	After 5 to 10 years	214,271	-	-	13,368		200,903	1.31			
Puerto Rico government obligations:											
	Due within one year	10,000	-	-	210		9,790	3.50			
	After 5 to 10 years	40,699	-	-	12,962		27,737	4.51			
	After 10 years	20,309	-	-	6,506		13,803	5.82			
United States and Puerto Rico government obligations		342,777	-	1	34,454		308,324	1.96			
Mortgage-backed securities:											
FHLMC certificates:											
	After 10 years	332,766	-	133	10,712		322,187	2.16			
GNMA certificates:											
	After 1 to 5 years	86	-	4	-		90	3.48			
	After 5 to 10 years	800	-	37	-		837	2.47			

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

	After 10 years	425,589	-	18,492	-	444,081	3.82
		426,475	-	18,533	-	445,008	3.82
FNMA certificates:							
	After 1 to 5 years	1,389	-	84	-	1,473	4.82
	After 5 to 10 years	7,765	-	389	-	8,154	4.09
	After 10 years	882,798	-	2,984	33,626	852,156	2.36
		891,952	-	3,457	33,626	861,783	2.38
Collateralized mortgage							
	obligations issued or						
	guaranteed by the FHLMC:						
	After 1 to 5 years	82	-	-	1	81	3.01
Other mortgage pass-through							
trust certificates:							
	Over 5 to 10 years	127	-	1	-	128	7.27
	After 10 years	55,048	14,310	-	-	40,738	2.24
		55,175	14,310	1	-	40,866	2.24
Total mortgage-backed							
	securities	1,706,450	14,310	22,124	44,339	1,669,925	2.69
Equity securities (without							
	contractual maturity) (1)	35	-	-	2	33	-
Total investment securities							
	available for sale	\$ 2,049,262	\$ 14,310	\$ 22,125	\$ 78,795	\$ 1,978,282	2.57
(1) Represents common shares of another financial institution in Puerto Rico.							

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options. The weighted average yield on investment securities available for sale is based on amortized cost and, therefore, does not give effect to changes in fair value. The net unrealized gain or loss on securities available for sale and the non credit loss component of OTTI are presented as part of OCI.

The following tables show the Corporation's available-for-sale investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of September 30, 2014 and December 31, 2013. The tables also include debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings. Unrealized losses for which OTTI had been recognized have been reduced by any subsequent recoveries in fair value.

	As of September 30, 2014											
	Less than 12 months				12 months or more				Total			
			Unrealized				Unrealized				Unrealized	
	Fair Value		Losses		Fair Value		Losses		Fair Value		Losses	
(In thousands)												
<b>Debt securities:</b>												
Puerto Rico government obligations	\$	-	\$	-	\$	45,503	\$	14,759	\$	45,503	\$	14,759
U.S. government agencies obligations		34,617		132		255,600		8,631		290,217		8,763
<b>Mortgage-backed securities:</b>												
FNMA		71,267		326		558,555		13,409		629,822		13,735
FHLMC		48,806		224		189,757		4,041		238,563		4,265
Other mortgage pass-through trust certificates		-		-		36,000		12,774		36,000		12,774
<b>Equity securities</b>		14		21		-		-		14		21
	\$	154,704	\$	703	\$	1,085,415	\$	53,614	\$	1,240,119	\$	54,317
	As of December 31, 2013											
	Less than 12 months				12 months or more				Total			
			Unrealized				Unrealized				Unrealized	
	Fair Value		Losses		Fair Value		Losses		Fair Value		Losses	
(In thousands)												
<b>Debt securities:</b>												
	\$	23,156	\$	5,977	\$	28,174	\$	13,701	\$	51,330	\$	19,678

Puerto Rico government obligations													
U.S. government agencies obligations	175,369		8,913		74,126		5,863		249,495			14,776	
<b>Mortgage-backed securities:</b>													
FNMA	748,215		33,626		-		-		748,215			33,626	
FHLMC	286,208		10,712		-		-		286,208			10,712	
Collateralized mortgage obligations													
issued or guaranteed by FHLMC	-		-		81		1		81			1	
Other mortgage pass-through trust certificates	-		-		40,738		14,310		40,738			14,310	
<b>Equity securities</b>	33		2		-		-		33			2	
	\$ 1,232,981		\$ 59,230		\$ 143,119		\$ 33,875		\$ 1,376,100			\$ 93,105	

*Assessment for OTTI*

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered an OTTI. A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The accounting literature requires the Corporation to assess whether the unrealized loss is other than temporary.

OTTI losses must be recognized in earnings if an investor has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if an investor does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI, if any, is recorded as a component of net impairment losses on investment securities in the accompanying consolidated statements of income (loss), while the remaining portion of the impairment loss is recognized in OCI, provided the Corporation does not intend to sell the underlying debt security and it is “more likely than not” that the Corporation will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, government-sponsored entities and the Treasury accounted for approximately 96% of the total available-for-sale portfolio as of September 30, 2014 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation’s OTTI assessment was concentrated mainly on private label mortgage-backed securities (“MBS”) with an amortized cost of \$48.8 million for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis;
- Changes in the near term prospects of the underlying collateral of a security, such as changes in default rates, loss severity given default, and significant changes in prepayment assumptions;
- The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and
- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer’s industry and actions taken by the issuer to deal with the present economic climate.

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

The Corporation recorded OTTI losses on available-for-sale debt securities as follows:

	Private Label MBS				Private Label MBS			
	Quarter ended September 30,				Nine-Month Period Ended September 30,			
	2014		2013		2014		2013	
(In thousands)								
Total other-than-temporary impairment losses	\$	-	\$	-	\$	-	\$	-
Portion of other-than-temporary impairment losses previously recognized in OCI		(245)		-		(245)		(117)
Net impairment losses recognized in earnings	\$	(245)	\$	-	\$	(245)	\$	(117)

The following table summarizes the roll-forward of credit losses on debt securities held by the Corporation for which a portion of an OTTI is recognized in OCI:										
	Quarter ended September 30,					Nine-Month Period Ended September 30,				
	2014		2013		2014		2013			
(In thousands)										
Credit losses at the beginning of the period	\$	5,389	\$	5,389	\$	5,389	\$	5,272		
Additions:										
Credit losses on debt securities for which an OTTI was										
previously recognized		245		-		245		117		
Ending balance of credit losses on debt securities held for										
which a portion of an OTTI was recognized in OCI	\$	5,634	\$	5,389	\$	5,634	\$	5,389		

During the first nine months of 2014 and 2013, the \$245 thousand and \$117 thousand credit-related impairment loss, respectively, is related to private label MBS, which are collateralized by fixed-rate mortgages on single-family residential properties in the United States. The interest rate on these private-label MBS is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The underlying mortgages are fixed-rate single-family loans with original high FICO scores (over 700) and moderate original loan-to-value ratios (under 80%), as well as moderate delinquency levels.

Based on the expected cash flows derived from the model, and since the Corporation does not have the intention to sell the securities and has sufficient capital and liquidity to hold these securities until a recovery of the fair value occurs, only the credit loss component was reflected in earnings. Significant assumptions in the valuation of the private label MBS were as follows:

	September 30, 2014			December 31, 2013		
	Weighted Average	Range		Weighted Average	Range	
Discount rate	14.5%	14.5%		14.5%	14.5%	
Prepayment rate	31%	19.21%-100.00%		29%	15.86%-100.00%	
Projected Cumulative Loss Rate	7.6%	0.94%-80.00%		6.8%	0.58%-38.16%	

No OTTI losses on equity securities held in the available-for-sale investment portfolio were recognized in the first nine months of 2014. The Corporation recorded OTTI losses of \$42 thousand on equity securities held in the available-for-sale investment portfolio in the first nine months of 2013.



Total proceeds from the sale of securities available for sale during the first nine months of 2014 amounted to \$4.9 million, including a \$0.3 million gain on the sale of a Puerto Rico government agency bond.

As of September 30, 2014, the Corporation held approximately \$61.1 million of Puerto Rico government and agencies bond obligations, mainly bonds of the Government Development Bank (“GDB”) and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio, which were reflected at their aggregate fair value of \$46.4 million. During the nine-month period ended September 30, 2014, the fair value of these obligations increased by \$4.9 million. In February 2014, Standard & Poor’s (“S&P”), Moody’s Investor Service (“Moody’s”) and Fitch Ratings (“Fitch”) downgraded the Commonwealth of Puerto Rico general obligation bonds and other obligations of Puerto Rico instrumentalities to a non-investment grade category. In July 2014, the Puerto Rico debt was downgraded further into speculative grade by these credit agencies after the enactment of The Puerto Rico Public Corporations Debt Enforcement and Recovery Act that provides a legislative framework for certain public corporations that are experiencing severe financial stress to address their financial obstacles through an orderly statutory process that allows them to handle their debts.

The issuers of Puerto Rico government and agencies bonds held by the Corporation have not defaulted, and the contractual payments on these securities have been made as scheduled. The Corporation has the ability and intent to hold these securities until a recovery of the fair value occurs, and it is not more likely than not that the Corporation will be required to sell the securities prior to such recovery. It is uncertain how the financial markets may react to any potential further rating downgrade of Puerto Rico’s debt. However, further deterioration in the fiscal situation could adversely affect the value of Puerto Rico’s government obligations. The Corporation will continue to closely monitor Puerto Rico’s political and economic status and evaluate the portfolio for any declines in value that could be considered other-than temporary.

## **NOTE 5 – OTHER EQUITY SECURITIES**

Institutions that are members of the FHLB system are required to maintain a minimum investment in FHLB stock. Such minimum investment is calculated as a percentage of aggregate outstanding mortgages, and an additional investment is required that is calculated as a percentage of total FHLB advances, letters of credit, and the collateralized portion of interest-rate swaps outstanding. The stock is capital stock issued at \$100 par value. Both stock and cash dividends may be received on FHLB stock.

As of September 30, 2014 and December 31, 2013, the Corporation had investments in FHLB stock with a book value of \$25.5 million and \$28.4 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for the quarter and nine-month period ended September 30, 2014 was \$0.3 million and \$0.9 million, respectively, compared to \$0.3 million and \$1.0 million, respectively, for the comparable periods in 2013.

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

The shares of FHLB stock owned by the Corporation are issued by the FHLB of New York. The FHLB of New York is part of the Federal Home Loan Bank System, a national wholesale banking network of 12 regional, stockholder-owned congressionally chartered banks. The Federal Home Loan Banks are all privately capitalized and operated by their member stockholders. The system is supervised by the Federal Housing Finance Agency, which ensures that the Home Loan Banks operate in a financially safe and sound manner, remain adequately capitalized and able to raise funds in the capital markets, and carry out their housing finance mission.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of September 30, 2014 and December 31, 2013 was \$0.3 million.

**NOTE 6 – LOANS HELD FOR INVESTMENT**

The following table provides information about the loan portfolio held for investment:

	September 30,		December 31,	
	2014		2013	
(In thousands)				
Residential mortgage loans, mainly secured by first mortgages	\$	2,819,648	\$	2,549,008
Commercial loans:				
Construction loans		141,689		168,713
Commercial mortgage loans		1,812,094		1,823,608
Commercial and Industrial loans (1)		2,515,384		2,788,250
Loans to a local financial institution collateralized by				
real estate mortgages (2)		-		240,072
Commercial loans		4,469,167		5,020,643
Finance leases		236,115		245,323
Consumer loans		1,790,472		1,821,196
Loans held for investment		9,315,402		9,636,170
Allowance for loan and lease losses		(225,434)		(285,858)
Loans held for investment, net	\$	9,089,968	\$	9,350,312
	(1) As of September 30, 2014 and December 31, 2013, includes \$1.1 billion and \$1.2 billion, respectively, of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.			
	(2) On May 30, 2014, FirstBank acquired from Doral Financial Corporation ("Doral") mortgage loans, mainly residential mortgage loans, having an unpaid principal balance of \$241.7 million (estimated fair value at acquisition of \$226.0 million) in full satisfaction of secured borrowings with a book value of \$232.9 million owed by Doral to FirstBank. Refer to Acquired Loans, including Purchased Credit-Impaired ("PCI") loans discussion below for additional information.			

Loans held for investment on which accrual of interest income had been discontinued were as follows:				
	September 30,		December 31,	
(In thousands)	2014		2013	
Non-performing loans:				
Residential mortgage	\$	185,025	\$	161,441
Commercial mortgage		169,967		120,107

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

Commercial and Industrial		130,917			114,833
Construction:					
Land		16,262			27,834
Construction-commercial		-			3,924
Construction-residential		13,849			27,108
Consumer:					
Auto loans		22,925			21,316
Finance leases		4,501			3,082
Other consumer loans		16,070			15,904
Total non-performing loans held for investment (1) (2) (3)	\$	559,516		\$	495,549
(1)	As of September 30, 2014 and December 31, 2013, excludes \$54.6 million and \$54.8 million, respectively, of non-performing loans held for sale.				
(2)	Amount excludes PCI loans with a carrying value of approximately \$104.3 million and \$4.8 million as of September 30, 2014 and December 31, 2013, respectively, primarily mortgage loans acquired from Doral in the second quarter of 2014, as further discussed below. These loans are not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.				
(3)	Non-performing loans exclude \$485.1 million and \$425.4 million of Trouble Debt Restructuring loans that are in compliance with modified terms and in accrual status as of September 30, 2014 and December 31, 2013, respectively.				

The Corporation's aging of the loans held for investment portfolio is as follows:									
As of September 30, 2014 (In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 days or more Past Due (1)	Total Past Due	Purchased Credit-Impaired Loans	Current	Total loans held for investment	90 days past due and still accruing (2)	
Residential mortgage:									
FHA/VA and other government-guaranteed loans (2) (3) (4)		8,225	\$ 77,238	\$ 85,463	\$ -	\$ 68,847	\$ 154,310	\$ 77,238	
Other residential mortgage loans (4)	-	87,502	201,883	289,385	99,535	2,276,418	2,665,338	16,858	
Commercial:									
Commercial and Industrial loans	16,775	11,637	149,037	177,449	-	2,337,935	2,515,384	18,120	
Commercial mortgage loans (4)	-	7,306	182,498	189,804	3,418	1,618,872	1,812,094	12,531	
Construction:									
Land (4)	-	401	16,434	16,835	-	40,940	57,775	172	
Construction-commercial	-	-	-	-	-	16,330	16,330	-	
Construction-residential	-	-	13,849	13,849	-	53,735	67,584	-	

(4)																				
Consumer:																				
Auto loans	83,686	21,352	22,925	127,963	-	966,671	1,094,634	-												
Finance leases	10,176	2,490	4,501	17,167	-	218,948	236,115	-												
Other consumer loans	7,240	9,335	19,114	35,689	1,360	658,789	695,838	3,044												
Total loans held for investment	\$ 117,877	\$ 148,248	\$ 687,479	\$ 953,604	\$ 104,313	\$ 8,257,485	\$ 9,315,402	\$ 127,963												

- (1) Includes non-performing loans and accruing loans that are contractually delinquent 90 days or more (i.e., FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges fees until charged-off at 180 days.
- (2) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$41.4 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 18 months delinquent, and are no longer accruing interest as of September 30, 2014.
- (3) As of September 30, 2014, includes \$24.6 million of defaulted loans collateralizing Government National Mortgage Association ("GNMA") securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.
- (4) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans and construction-residential loans past due 30-59 days amounted to \$15.1 million, \$179.0 million, \$40.5 million, \$0.5 million, and \$1.7 million, respectively.

As of December 31, 2013 (In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 days or more Past Due (1)				Total loans held for investment	90 days past due and still accruing (2)
				Total Past Due	Purchased Credit-Impaired	Current		

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

										Loans				
Residential mortgage:														
FHA/VA and other government-guaranteed loans (2) (3) (4)		2,180	\$ 78,645	\$ 90,825	\$ -	\$ 104,401	\$ 195,226	\$ 78,645						
Other residential mortgage loans (4)	-	88,898	172,286	261,184	-	2,092,598	2,353,782	10,845						
Commercial:														
Commercial and Industrial loans	21,029	5,454	134,233	160,716	-	2,867,606	3,028,322	19,400						
Commercial mortgage loans (4)	-	5,428	126,674	132,102	-	1,691,506	1,823,608	6,567						
Construction:														
Land (4)	-	358	27,871	28,229	-	52,145	80,374	37						
Construction-commercial	-	-	3,924	3,924	-	12,907	16,831	-						
Construction-residential (4)	-	-	27,108	27,108	-	44,400	71,508	-						
Consumer:														
Auto loans	79,279	17,944	21,316	118,539	-	993,781	1,112,320	-						
Finance leases	10,275	3,536	3,082	16,893	-	228,430	245,323	-						
Other consumer	11,710	8,691	20,492	40,893	4,791	663,192	708,876	4,588						

loans																				
Total loans held for investment	\$ 122,293	\$ 142,489	\$ 615,631	\$ 880,413	\$ 4,791	\$ 8,750,966	\$ 9,636,170	\$ 120,082												
(1)	Includes non-performing loans and accruing loans that are contractually delinquent 90 days or more (i.e. FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged-off at 180 days.																			
(2)	It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$37.0 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 18 months delinquent, and are no longer accruing interest as of December 31, 2013.																			
(3)	As of December 31, 2013, includes \$11.5 million of defaulted loans collateralizing GNMA securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.																			
(4)	According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans and construction-residential loans past due 30-59 days amounted to \$23.9 million, \$166.7 million, \$18.4 million, \$0.9 million and \$2.5 million, respectively.																			



The Corporation's credit quality indicators by loan type as of September 30, 2014 and December 31, 2013 are summarized below:													
Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness category:													
		Substandard			Doubtful			Loss			Total Adversely Classified (1)		Total Portfolio
September 30, 2014													
(In thousands)													
Commercial mortgage		\$	294,134	\$	1,710	\$	-	\$	295,844	\$	1,812,094		
Construction:													
Land			17,648		-		-		17,648		57,775		
Construction-commercial			11,790		-		-		11,790		16,330		
Construction-residential			13,072		777		-		13,849		67,584		
Commercial and Industrial			225,941		5,515		794		232,250		2,515,384		
Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness category:													
		Substandard			Doubtful			Loss			Total Adversely Classified (1)		Total Portfolio
December 31, 2013													
(In thousands)													
Commercial mortgage		\$	317,365	\$	9,160	\$	234	\$	326,759	\$	1,823,608		
Construction													
Land			31,777		3,308		52		35,137		80,373		
Construction-commercial			16,022		-		-		16,022		16,831		
Construction-residential			27,829		2,209		241		30,279		71,509		
Commercial and Industrial			205,807		7,998		973		214,778		3,028,322		
(1)		Excludes \$54.6 million (\$7.8 million land, \$39.1 million construction-commercial, \$0.9 million construction-residential and \$6.8 million commercial mortgage) and \$54.8 million (\$7.8 million land, \$39.1 million construction-commercial, \$0.9 million construction-residential and \$7.0 million commercial mortgage) as of September 30, 2014 and December 31, 2013, respectively, of non-performing loans held for sale.											

The Corporation considers a loan as adversely classified if its risk rating is Substandard, Doubtful or Loss. These categories are defined as follows:

**Substandard-** A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful-** Doubtful classifications have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. A Doubtful classification may be appropriate in cases where significant risk exposures are perceived, but Loss cannot be determined because of specific reasonable pending factors which may strengthen the credit in the near term.

**Loss-** Assets classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. There is little or no prospect for near term improvement and no realistic strengthening action of significance pending.

<b>September 30, 2014</b>		<b>Consumer Credit Exposure-Credit Risk Profile based on payment activity</b>									
		<b>Residential Real-Estate</b>					<b>Consumer</b>				
		<b>FHA/VA/ Guaranteed (1)</b>		<b>Other residential loans</b>			<b>Auto</b>		<b>Finance Leases</b>		<b>Other Consumer</b>
(In thousands)											
Performing		\$	154,310	\$	2,380,778	\$	1,071,709	\$	231,614	\$	678,408
Purchased Credit-Impaired (2)			-		99,535		-		-		1,360
Non-performing			-		185,025		22,925		4,501		16,070
Total		\$	154,310	\$	2,665,338	\$	1,094,634	\$	236,115	\$	695,838
(1)		It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$41.4 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 18 months delinquent, and are no longer accruing interest as of September 30, 2014.									
(2)		PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.									
<b>December 31, 2013</b>		<b>Consumer Credit Exposure-Credit Risk Profile based on payment activity</b>									
		<b>Residential Real-Estate</b>					<b>Consumer</b>				
		<b>FHA/VA/ Guaranteed (1)</b>		<b>Other residential loans</b>			<b>Auto</b>		<b>Finance Leases</b>		<b>Other Consumer</b>
(In thousands)											
Performing		\$	195,226	\$	2,192,341	\$	1,091,004	\$	242,241	\$	688,181
Purchased Credit-Impaired (2)			-		-		-		-		4,791
Non-performing			-		161,441		21,316		3,082		15,904
Total		\$	195,226	\$	2,353,782	\$	1,112,320	\$	245,323	\$	708,876
(1)		It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$37.0 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 18 months delinquent, and are no longer accruing interest as of December 31, 2013.									
(2)		PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.									



The following tables present information about impaired loans, excluding purchased credit-impaired loans, which are reported separately, as discussed below:

Impaired Loans (In thousands)												
							Quarter ended		Nine-month Period Ended			
							September 30, 2014					
		Recorded Investment	Unpaid Principal Balance	Related Specific Allowance	Year-To-Date Average Recorded Investment	Interest Income Recognized/ Accrual Basis	Interest Income Recognized/ Cash Basis	Interest Income Recognized/ Accrual Basis	Interest Income Recognized/ Cash Basis			
<b>As of September 30, 2014</b>												
<b>With no related allowance recorded:</b>												
FHA/VA-Guaranteed loans	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other residential mortgage loans	88,126	99,529	-	91,683	372	242	829	553				
Commercial:												
Commercial mortgage loans	103,282	116,016	-	105,065	286	536	1,059	1,512				
Commercial and Industrial Loans	44,683	54,955	-	49,686	-	240	-	518				
Construction:												
Land	1,003	1,072	-	1,009	6	4	18	5				
Construction-commercial	-	-	-	-	-	-	-	-				
Construction-residential	4,706	4,802	-	4,681	42	2	125	5				
Consumer:												
Auto loans	-	-	-	-	-	-	-	-				
Finance leases	-	-	-	-	-	-	-	-				
Other consumer loans	1,641	2,939	-	1,637	5	18	19	41				
	\$ 243,441	\$ 279,313	\$ -	\$ 253,761	\$ 711	\$ 1,042	\$ 2,050	\$ 2,634				
<b>With an allowance recorded:</b>												
FHA/VA-Guaranteed loans	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -				
	333,697	371,553	11,658	337,227	3,713	594	10,864	1,799				

Other residential mortgage loans										
Commercial:										
Commercial mortgage loans	135,050	159,717	14,128	142,484	390	203	1,179	1,126		
Commercial and Industrial Loans	196,730	224,723	21,267	197,862	1,897	24	3,033	380		
Construction:										
Land	11,031	18,929	938	13,517	15	7	42	22		
Construction-commercial	11,790	11,790	790	11,944	-	128	-	344		
Construction-residential	10,911	14,147	1,208	12,322	-	-	-	-		
Consumer:										
Auto loans	15,733	15,733	2,388	16,692	264	-	810	-		
Finance leases	2,163	2,163	170	2,410	44	-	151	-		
Other consumer loans	12,468	13,172	2,737	12,561	537	11	1,192	23		
	\$ 729,573	\$ 831,927	\$ 55,284	\$ 747,019	\$ 6,860	\$ 967	\$ 17,271	\$ 3,694		
<b>Total:</b>										
FHA/VA-Guaranteed loans	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -		
Other residential mortgage loans	421,823	471,082	11,658	428,910	4,085	836	11,693	2,352		
Commercial:										
Commercial mortgage loans	238,332	275,733	14,128	247,549	676	739	2,238	2,638		
Commercial and Industrial Loans	241,413	279,678	21,267	247,548	1,897	264	3,033	898		
Construction:										
Land	12,034	20,001	938	14,526	21	11	60	27		
Construction-commercial	11,790	11,790	790	11,944	-	128	-	344		
Construction-residential	15,617	18,949	1,208	17,003	42	2	125	5		
Consumer:										
Auto loans	15,733	15,733	2,388	16,692	264	-	810	-		
Finance leases	2,163	2,163	170	2,410	44	-	151	-		
Other consumer loans	14,109	16,111	2,737	14,198	542	29	1,211	64		
	\$ 973,014	\$ 1,111,240	\$ 55,284	\$ 1,000,780	\$ 7,571	\$ 2,009	\$ 19,321	\$ 6,328		

(In thousands)									
	Recorded Investments		Unpaid Principal Balance		Related Specific Allowance		Year-To-Date Average Recorded Investment		
<b>As of December 31, 2013</b>									
<b>With no related allowance recorded:</b>									
FHA/VA-Guaranteed loans	\$ -		\$ -		\$ -		\$ -		
Other residential mortgage loans	220,428		237,709		-		222,617		
Commercial:									
Commercial mortgage loans	69,484		73,723		-		71,367		
Commercial and Industrial Loans	32,418		56,831		-		37,946		
Construction:									
Land	359		366		-		360		
Construction-commercial	-		-		-		-		
Construction-residential	14,761		19,313		-		17,334		
Consumer:									
Auto loans	-		-		-		-		
Finance leases	-		-		-		-		
Other consumer loans	4,035		4,450		-		3,325		
	\$ 341,485		\$ 392,392		\$ -		\$ 352,949		
<b>With an allowance recorded:</b>									
FHA/VA-Guaranteed loans	\$ -		\$ -		\$ -		\$ -		
Other residential mortgage loans	190,566		212,028		18,125		193,372		
Commercial:									
Commercial mortgage loans	149,888		163,656		32,189		153,992		
Commercial and Industrial Loans	154,686		170,191		26,686		162,786		
Construction:									
Land	27,711		40,348		10,455		28,906		
Construction-commercial	16,022		16,238		8,873		16,157		
Construction-residential	13,864		13,973		2,816		13,640		
Consumer:									
Auto loans	14,121		14,122		1,829		12,937		
Finance leases	2,359		2,359		73		2,219		
Other consumer loans	8,410		8,919		1,555		8,919		
	\$ 577,627		\$ 641,834		\$ 102,601		\$ 592,928		
<b>Total:</b>									

FHA/VA-Guaranteed loans	\$	-	\$	-	\$	-	\$	-
Other residential mortgage loans		410,994		449,737		18,125		415,989
Commercial:								
Commercial mortgage loans		219,372		237,379		32,189		225,359
Commercial and Industrial Loans		187,104		227,022		26,686		200,732
Construction:								
Land		28,070		40,714		10,455		29,266
Construction-commercial		16,022		16,238		8,873		16,157
Construction-residential		28,625		33,286		2,816		30,974
Consumer:								
Auto loans		14,121		14,122		1,829		12,937
Finance leases		2,359		2,359		73		2,219
Other consumer loans		12,445		13,369		1,555		12,244
	\$	919,112	\$	1,034,226	\$	102,601	\$	945,877

Interest income of approximately \$8.8 million (\$7.4 million on an accrual basis and \$1.4 million on a cash basis) and \$23.6 million (\$19.3 million on an accrual basis and \$4.3 million on a cash basis) was recognized on impaired loans for the third quarter and nine-month period ended September 30, 2013, respectively.



The following tables show the activity for impaired loans and the related specific reserve for the quarter and nine-month							
period ended September 30, 2014:							
				<b>Quarter Ended</b>		<b>Nine-Month Period Ended</b>	
				<b>September 30, 2014</b>			
				<b>(In thousands)</b>			
<b>Impaired Loans:</b>							
Balance at beginning of period				\$	908,858	\$	919,112
Loans determined impaired during the period					118,549		271,792
Charge-offs					(31,263)		(95,948)
Increases to impaired loans-additional disbursements					1,768		2,687
Foreclosures					(5,332)		(13,472)
Loans no longer considered impaired					(1,009)		(18,740)
Paid in full or partial payments					(18,557)		(92,417)
Balance at end of period				\$	973,014	\$	973,014

				<b>Quarter Ended</b>		<b>Nine-Month Period Ended</b>	
				<b>September 30, 2014</b>			
				<b>(In thousands)</b>			
<b>Specific Reserve:</b>							
Balance at beginning of period				\$	68,358	\$	102,601
Provision for loan losses					18,189		48,631
Charge-offs					(31,263)		(95,948)
Balance at end of period				\$	55,284	\$	55,284

### Acquired loans, including PCI Loans

On May 30, 2014, FirstBank purchased from Doral all of its rights, title and interests in first and second mortgage loans having an unpaid principal balance of approximately \$241.7 million for an aggregate purchase price of approximately \$232.9 million. Doral had pledged the mortgage loans to FirstBank as collateral for secured borrowings pursuant to a series of credit agreements between the parties entered into in 2006. As consideration for the purchase of the mortgage loans, FirstBank credited approximately \$232.9 million as full satisfaction of the outstanding balance of the Doral secured borrowings plus interest owed to FirstBank. The estimated fair value of the mortgage loans at acquisition was \$226.0 million. This transaction resulted in a loss of \$6.9 million derived from the difference between the fair value of the mortgage loans acquired, \$226.0 million, and the book value of the secured borrowings of \$232.9 million. Approximately \$5.5 million of the loss was part of the general allowance for loan losses established for commercial loans in prior periods; thus, an additional charge of \$1.4 million to the provision was recorded in the second quarter of 2014. In addition, the Corporation recorded \$0.6 million of professional service fees in the second quarter of 2014 specifically related to this transaction.

Acquired loans are recorded at fair value at the date of acquisition. The Corporation concluded that loans with a contractual unpaid principal balance of \$119.2 million and an estimated fair value at acquisition of \$102.8 million were acquired with evidence of credit quality deterioration and, as purchased credit impaired loans, have been accounted for under ASC 310-30, while loans with a contractual unpaid principal balance of \$122.5 million and an estimated fair value at acquisition of \$123.2 million are non-credit impaired purchased loans that have been accounted for under ASC 310-20.

Subsequent to the day-one fair value, acquired loans accounted for under ASC 310-20 are accounted for consistently with other originated loans, potentially becoming non-accrual or impaired, as well as being classified under the Corporation's standard practices and procedures. In addition, these loans are considered in the determination of the allowance for loan losses.

Under ASC 310-30, the acquired PCI loans were aggregated into pools based on similar characteristics (i.e. delinquency status, loan terms). Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. The loans which are accounted for under ASC 310-30 by the Corporation are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected. The Corporation measures additional losses for this portfolio when it is probable the Corporation will be unable to collect all cash flows expected at acquisition plus additional cash flows expected to be collected arising from changes in estimates after acquisition.

On May 30, 2012, the Corporation reentered the credit card business with the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit card loans from FIA Card Services ("FIA"). These loans were recorded on the Consolidated Statement of Financial Condition at estimated fair value on the acquisition date of \$368.9 million.

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

The Corporation concluded that loans with a contractual outstanding unpaid principal and interest balance at acquisition of \$34.6 million and an estimated fair value of \$15.7 million were PCI loans.

The carrying amount of PCI loans follows:					
		September 30,		December 31,	
		2014		2013	
(In thousands)					
Residential mortgage loans	\$	99,535		\$	-
Commercial mortgage loans		3,418			-
Credit Cards		1,360			4,791
	\$	104,313		\$	4,791

The following tables present PCI loans by past due status as of September 30, 2014 and December 31, 2013:												
As of September 30, 2014												
(In thousands)												
	30-59 Days		60-89 Days		90 days or more		Total Past Due		Current		Total PCI loans	
Residential mortgage loans (1)	\$	-	\$	11,210	\$	14,963	\$	26,173	\$	73,362	\$	99,535
Commercial mortgage loans (1)		-		290		497		787		2,631		3,418
Credit Cards		79		48		113		240		1,120		1,360
	\$	79	\$	11,548	\$	15,573	\$	27,200	\$	77,113	\$	104,313
(1) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage and commercial mortgage loans are considered past due when the borrower is in arrears two or more monthly payments. PCI residential mortgage loans and commercial mortgage loans past due 30-59 days amounted to \$16.8 million and \$0.7 million, respectively.												
As of December 31, 2013												
(In thousands)												
	30-59 Days		60-89 Days		90 days or more		Total Past Due		Current		Total PCI loans	
Credit Cards	\$	377	\$	354	\$	573	\$	1,304	\$	3,487	\$	4,791

#### Initial Fair Value and Accrutable Yield of PCI Loans

At acquisition, the Corporation estimated the cash flows the Corporation expected to collect on PCI loans. Under the accounting guidance for PCI loans, the difference between the contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccrutable difference. This difference is neither accreted into income nor recorded on the Corporation's Consolidated Statement of Financial Condition. The excess of cash flows expected to be collected over the estimated fair value is referred to as the accrutable yield and is recognized in interest income over the remaining life of the loans, using the effective-yield method.

The following table presents acquired loans from Doral accounted for pursuant to ASC 310-30 as of the May 30, 2014 acquisition date:

(In thousands)		

Contractually- required principal and interest	\$	275,842
Less: Nonaccretable difference		(86,252)
Cash flows expected to be collected		189,590
Less: Accretable yield		(86,759)
Fair value of loans acquired in 2014	\$	102,831

The cash flows expected to be collected consider the estimated remaining life of the underlying loans and include the effects of estimated prepayments.

*Changes in accretable yield of acquired loans*

Subsequent to acquisition, the Corporation is required to periodically evaluate its estimate of cash flows expected to be collected. These evaluations, performed quarterly, require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and nonaccretable difference or reclassifications from nonaccretable yield to accretable. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loan or pool of loans. Decreases in expected cash flows due to further credit deterioration will generally result in an impairment charge recognized in the Corporation's provision for loan and lease losses, resulting in an increase to the allowance for loan losses. During the first nine months of 2014, the Corporation did not record charges to the provision for loan losses related to PCI loans, most of which were acquired on May 30, 2014.

Changes in the accretable yield of PCI loans for the quarter and nine-month period ended September 30, 2014 and 2013 were as follows:										
	Quarter ended September 30, 2014		Quarter ended September 30, 2013		Nine month period ended September 30, 2014		Nine month period ended September 30, 2013			
(In thousands)										
Balance at beginning of period	\$	86,147	\$	406	\$	-	\$	2,171		
Additions (accretable yield at acquisition of loans from Doral)		-		-		86,759		-		
Accretion recognized in earnings		(1,850)		(406)		(2,462)		(819)		
Reclassification to non accretable		-		-		-		(1,352)		
Balance at end of period	\$	84,297	\$	-	\$	84,297	\$	-		

Changes in the carrying amount of loans accounted for pursuant to ASC 310-30 follows:										
	Quarter Ended				Nine-Month Period Ended					
	September 30, 2014				September 30, 2014					
(In thousands)										
Balance at beginning of period (1)	\$	105,619			\$	4,791				
Additions (2)		-				102,831				
Accretion		1,850				2,462				
Collections and charge-offs		(3,156)				(5,771)				
Ending balance	\$	104,313			\$	104,313				
(1)	For the nine month period ended September 30, 2014, the beginning balance relates to PCI loans acquired as part of the credit card portfolio purchased in the second quarter of 2012.									
(2)	Represents the estimated fair value of the PCI loans acquired from Doral at the date of acquisition.									

The outstanding principal balance of PCI loans, including amounts charged off by the Corporation, amounted to \$137.5 million as of September 30, 2014 (December 2013- \$22.7 million).



## Purchases and Sales of Loans

In addition to loans acquired from Doral, during the first nine months of 2014, the Corporation purchased \$115.1 million of residential mortgage loans consistent with a strategic program established by the Corporation in 2005 to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. Generally, the loans purchased from mortgage bankers were conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility to retain or sell the loans, including through securitization transactions, depending upon the Corporation's interest rate risk management strategies. When the Corporation sells such loans, it generally keeps the servicing of the loans. Refer to Note 24, Subsequent Events, for additional information related to an additional purchase of approximately \$192.6 million of performing residential mortgage loans from Doral completed on October 2, 2014.

In the ordinary course of business, the Corporation sells residential mortgage loans (originated or purchased) to the GNMA and government-sponsored entities ("GSEs"). GNMA and GSEs, such as Fannie Mae ("FNMA") and Freddie Mac ("FHLMC"), generally securitize the transferred loans into mortgage-backed securities for sale into the secondary market. The Corporation sold approximately \$100.9 million of performing residential mortgage loans to FNMA and FHLMC during the first nine months of 2014. Also, the Corporation securitized \$144.6 million of FHA/VA mortgage loans into GNMA mortgage-backed securities during the first nine months of 2014. The Corporation's continuing involvement in these loan sales consists primarily of servicing the loans. In addition, the Corporation agreed to repurchase loans when it breaches any of the representations and warranties included in the sale agreement. These representations and warranties are consistent with the GSEs' selling and servicing guidelines (i.e., ensuring that the mortgage was properly underwritten according to established guidelines).

For loans sold to GNMA, the Corporation holds an option to repurchase individual delinquent loans issued on or after January 1, 2003 when the borrower fails to make any payment for three consecutive months. This option gives the Corporation the ability, but not the obligation, to repurchase the delinquent loans at par without prior authorization from GNMA.

Under ASC Topic 860, Transfer and Servicing, once the Corporation has the unilateral ability to repurchase the delinquent loan, it is considered to have regained effective control over the loan and is required to recognize the loan and a corresponding repurchase liability on the balance sheet regardless of the Corporation's intent to repurchase the loan.

During the first nine months of 2014, the Corporation repurchased pursuant to its repurchase option with GNMA \$6.4 million of loans previously sold to GNMA. The principal balance of these loans is fully guaranteed and the risk of loss related to repurchases is generally limited to the difference between the delinquent interest payment advanced to GNMA computed at the loan's interest rate and the interest payments reimbursed by FHA, which are computed at a pre-determined debenture rate. Repurchases of GNMA loans allow the Corporation, among other things, to maintain

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements



acceptable delinquency rates on outstanding GNMA pools and remain as a seller and servicer in good standing with GNMA. The Corporation generally remediates any breach of representations and warranties related to the underwriting of such loans according to established GNMA guidelines without incurring losses. The Corporation does not maintain a liability for estimated losses as a result of breaches in representations and warranties.

Loan sales to FNMA and FHLMC are without recourse in relation to the future performance of the loans. The Corporation repurchased at par loans previously sold to FNMA and FHLMC in the amount of \$1.6 million during the first nine months of 2014. The Corporation's risk of loss with respect to these loans is also minimal as these repurchased loans are generally performing loans with documentation deficiencies. A \$0.7 million loss was recorded in the first nine months of 2014 related to breaches in representations and warranties and a \$0.5 million charge was recorded related to compensatory fees imposed by GSEs. Historically, losses experienced related to breaches in representations and warranties have been immaterial. As a consequence, as of September 30, 2014, the Corporation does not maintain a liability for estimated losses on loans expected to be repurchased as a result of breaches in loan and servicer representations and warranties.

The Corporation sold during the third quarter of 2014, a \$15.0 million participation of a commercial mortgage loan.

### **Bulk Sales of Assets and Transfer of Loans to Held For Sale**

On June 21, 2013, the Corporation announced that it had completed a sale of non-performing residential mortgage loans with a book value of \$203.8 million and OREO properties with a book value of \$19.2 million in a cash transaction. The sales price of this bulk sale was \$128.3 million. Approximately \$30.1 million of reserves had already been allocated to the loans. This transaction resulted in total charge-offs of \$98.0 million and an incremental loss of \$69.8 million, reflected in the provision for loan and lease losses for the first nine months of 2013. In addition, the Corporation recorded \$3.1 million of professional service fees specifically related to this bulk sale of non-performing residential assets. This transaction resulted in a total pre-tax loss of \$72.9 million.

On March 28, 2013, the Corporation completed the sale of adversely classified loans with a book value of \$211.4 million (\$100.1 million of commercial and industrial loans, \$68.8 million of commercial mortgage loans, \$41.3 million of construction loans, and \$1.2 million of residential mortgage loans), and \$6.3 million of OREO properties in a cash transaction. Included in the bulk sale was \$185.0 million of non-performing assets. The sales price of this bulk sale was \$120.2 million. Approximately \$39.9 million of reserves had already been allocated to the loans. This transaction resulted in total charge-offs of \$98.5 million and an incremental loss of \$58.9 million, reflected in the provision for loan and lease losses for the first nine months of 2013. In addition, the Corporation recorded \$3.9 million of professional fees specifically related to this bulk sale of assets. This transaction resulted in a total pre-tax loss of \$62.8 million.

In addition, during the first quarter of 2013, the Corporation transferred to held for sale non-performing loans with an aggregate book value of \$181.6 million. These transfers resulted in charge-offs of \$36.0 million and an incremental loss of \$5.2 million reflected in the provision for loan and lease losses for the first nine months of 2013.

During the second quarter of 2013, the Corporation completed the sale of a \$40.8 million non-performing commercial mortgage loan that was among the loans transferred to held for sale in the first quarter of 2013 without incurring additional losses.

In a separate transaction during 2013, the Corporation foreclosed on the collateral underlying \$39.2 million related to one of the loans written-off and transferred to held for sale in the first quarter of 2013. Furthermore, in the third quarter of 2013, approximately \$6.4 million of construction loans held for sale participations were paid-off.

The Corporation's primary goal with respect to these sales was to accelerate the disposition of non-performing assets, which is the main priority of the Corporation's Strategic Plan. The opportunistic sale of distressed assets is a pivotal and tactical step in the Corporation's efforts to reduce balance sheet risk, improve earnings in the future through reductions of credit-related-costs and enhance credit quality consistent with regulators' expectations of adequate levels of adversely classified assets for financial institutions.

### **Loan Portfolio Concentration**

The Corporation's primary lending area is Puerto Rico. The Corporation's banking subsidiary, First Bank, also lends in the USVI and BVI markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment of \$9.3 billion as of September 30, 2014, approximately 83% have credit risk concentration in Puerto Rico, 10% in the United States, and 7% in the USVI and BVI.

As of September 30, 2014, the Corporation had \$364.3 million in credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$316.3 million was outstanding, compared to \$397.8 million outstanding as of December 31, 2013. In addition, the outstanding balance of facilities granted to the government of the Virgin Islands amounted to \$40.8 million as of September 30, 2014, compared to \$60.6 million as of December 31, 2013. Approximately \$201.4 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of the applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$24.8 million consists of loans to units of the central government, and approximately \$90.1 million consists of loans to public corporations that generally receive revenues from the rates they charge for services or products, such as electric power services, including a \$75.0 million credit extended to the Puerto Rico Electric Power Authority (“PREPA”) for fuel purchases that have priority over senior bonds and other debt. In August 2014, PREPA entered into a forbearance agreement with a group of banks, including FirstBank, to extend further its maturing credit lines to March 31, 2015. As a result of the forbearance, this credit facility was classified as a Trouble debt Restructuring (“TDR”) during the third quarter of 2014. The loan was maintained in accrual status based on the estimated cash flows analysis performed on this noncollateral dependent loan, repayment prospects and compliance with contractual terms. Major public corporations have varying degrees of independence from the central government and many receive appropriations or other payments from the Puerto Rico’s government general fund. Debt issued by the central government can either carry the full faith, credit and taxing power of the Commonwealth of Puerto Rico or represent an obligation that is subject to annual budget appropriations.

Furthermore, the Corporation had \$200.4 million outstanding as of September 30, 2014 in financing to the hotel industry in Puerto Rico guaranteed by the Puerto Rico Tourism Development Fund (“TDF”). The TDF is a subsidiary of the GDB that works with private-sector financial institutions to structure financings for new hospitality projects.

As disclosed in Note 4, S&P, Moody’s and Fitch downgraded the credit rating of the Commonwealth of Puerto Rico’s debt and certain public corporations to non-investment grade categories. The Corporation cannot predict at this time the impact that the current fiscal situation of the Commonwealth of Puerto Rico and the various legislative and other measures adopted and to be adopted by the Puerto Rico government in response to such fiscal situation will have on the Puerto Rico economy and on the Corporation’s financial condition and results of operations.

### **Troubled Debt Restructurings**

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government’s Home Affordable Modification Program guidelines. Depending upon the nature of borrowers’ financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans in the U.S. mainland fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor’s financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of September 30, 2014, the Corporation's total TDR loans held for investment of \$701.1 million consisted of \$348.4 million of residential mortgage loans, \$174.3 million of commercial and industrial loans, \$134.9 million of commercial mortgage loans, \$13.2 million of construction loans, and \$30.2 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to \$0.2 million as of September 30, 2014.

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently (offered up to 2010) or for a period of up to two years (step-up rates). Additionally, in certain cases, the restructuring may provide for the forgiveness of contractually due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available only to those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in a foreclosure action absent some lender concession. Nevertheless, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in or that have been offered a binding trial modification are classified as TDRs when the trial offer is made and continue to be classified as TDRs regardless of whether the borrower enters into a permanent modification. As of September 30, 2014, we classified an additional \$11.2 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collections function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of the commercial and industrial, commercial mortgage and construction loan portfolios, the Corporation's Special Asset Group ("SAG") focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists, and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third-party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and assists with the restructuring of large commercial loans.

In addition, the Corporation extends, renews, and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which are mainly one year in term and therefore are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon

changes in the borrower's business needs, use of funds, timing of completion of projects, and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals, and restructurings are done in the normal course of business and not considered concessions, and the loans continue to be recorded as performing.

Selected information on TDRs that includes the recorded investment by loan class and modification type is summarized in the following tables. This information reflects all TDRs:													
September 30, 2014													
(In thousands)	Interest rate below market		Maturity or term extension		Combination of reduction in interest rate and extension of maturity		Forgiveness of principal and/or interest		Other (1)		Total		
Troubled Debt Restructurings:													
Non-FHA/VA Residential Mortgage loans	\$	23,658	\$	6,046	\$	282,922	\$	-	\$	35,820	\$	348,446	
Commercial Mortgage Loans		29,889		12,837		74,364		-		17,844		134,934	
Commercial and Industrial Loans		7,602		80,742		33,051		3,089		49,813		174,297	
Construction Loans:													
Land		811		203		1,714		-		539		3,267	
Construction-residential		6,155		244		3,127		-		434		9,960	
Consumer Loans - Auto		-		441		9,292		-		6,000		15,733	
Finance Leases		-		437		1,726		-		-		2,163	
Consumer Loans - Other		38		155		9,879		509		1,762		12,343	
Total Troubled Debt Restructurings (2)	\$	68,153	\$	101,105	\$	416,075	\$	3,598	\$	112,212	\$	701,143	
(1) Other concessions granted by the Corporation include deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation or a combination of the concessions listed in the table.													
(2) Excludes TDRs held for sale amounting to \$45.7 million as of September 30, 2014													



December 31, 2013									
(In thousands)	Interest rate below market	Maturity or term extension	Combination of reduction in interest rate and extension of maturity	Forgiveness of principal and/or interest	Other (1)	Total			
Troubled Debt Restructurings:									
Non-FHA/VA Residential Mortgage loans	\$ 23,428	\$ 6,059	\$ 274,562	\$ -	\$ 33,195	\$ 337,244			
Commercial Mortgage Loans	36,543	12,985	83,993	7	20,048	153,576			
Commercial and Industrial Loans	12,099	11,341	12,835	3,122	52,554	91,951			
Construction Loans:									
Land	878	2,012	1,760	-	675	5,325			
Construction-commercial	-	-	3,924	-	-	3,924			
Construction-residential	6,054	160	3,173	994	513	10,894			
Consumer Loans - Auto	-	706	8,350	-	5,066	14,122			
Finance Leases	-	1,286	1,072	-	-	2,358			
Consumer Loans - Other	227	256	8,638	-	1,743	10,864			
Total Troubled Debt Restructurings (2)	\$ 79,229	\$ 34,805	\$ 398,307	\$ 4,123	\$ 113,794	\$ 630,258			
(1)	Other concessions granted by the Corporation include deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation or a combination of the concessions listed in the table.								
(2)	Excludes TDRs held for sale amounting to \$45.9 million as of December 31, 2013.								

The following table presents the Corporation's TDR activity:									
(In thousands)						Quarter Ended	Nine-Month Period Ended		
						September 30, 2014			

Beginning balance of TDRs				\$	628,233		\$	630,258
New TDRs					94,864			149,609
Increases to existing TDRs - additional								
disbursements					1,197			1,331
Charge-offs post modification					(12,598)			(39,246)
Foreclosures					(768)			(3,369)
Paid-off and partial payments					(9,785)			(37,440)
Ending balance of TDRs				\$	701,143		\$	701,143

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed.

Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation's interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and OREO costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses. A TDR loan that specifies an interest rate that at the time of the restructuring is greater than or equal to the rate the Corporation is willing to accept for a new loan with comparable risk may not be reported as a TDR or an impaired loan in the calendar years subsequent to the restructuring if it is in compliance with its modified terms. The Corporation did not remove loans from the TDR classification during the first nine months of 2014.

The following table provides a breakdown between accrual and nonaccrual status of TDRs:								
(In thousands)								
September 30, 2014								
	Accrual			Nonaccrual (1) (2)			Total TDRs	
Non-FHA/VA Residential Mortgage loans	\$	259,749		\$	88,697		\$	348,446
Commercial Mortgage Loans		72,601			62,333			134,934
Commercial and Industrial Loans		127,178			47,119			174,297
Construction Loans:								
Land		972			2,295			3,267
Construction-residential		3,371			6,589			9,960
Consumer Loans - Auto		9,584			6,149			15,733
Finance Leases		1,916			247			2,163
Consumer Loans - Other		9,712			2,631			12,343
Total Troubled Debt Restructurings	\$	485,083		\$	216,060		\$	701,143
<p>(1) Included in non-accrual loans are \$65.8 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability.</p> <p>(2) Excludes non-accrual TDRs held for sale with a carrying value of \$45.7 million as of September 30, 2014.</p>								

(In thousands)								
December 31, 2013								
	Accrual			Nonaccrual (1) (2)			Total TDRs	
Non- FHA/VA Residential Mortgage loans	\$	263,919		\$	73,324		\$	337,243
Commercial Mortgage Loans		84,419			69,156			153,575
Commercial and Industrial Loans		53,509			38,441			91,950
Construction Loans:								
Land		1,000			4,325			5,325
Construction-commercial		-			3,924			3,924
Construction-residential		3,332			7,562			10,894
Consumer Loans - Auto		8,512			5,610			14,122
Finance Leases		2,275			85			2,360

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Consumer Loans - Other			8,417			2,448			10,865
Total Troubled Debt Restructurings		\$	425,383		\$	204,875		\$	630,258
(1)	Included in non-accrual loans are \$95.7 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability.								
(2)	Excludes non-accrual TDRs held for sale with a carrying value of \$45.9 million as of December 31, 2013.								

TDRs exclude restructured residential mortgage loans that are guaranteed by the U.S. federal government (i.e., FHA/VA loans) totaling \$72.4 million. The Corporation excludes FHA/VA guaranteed loans from TDRs given that, in the event that the borrower defaults on the loan, the principal and interest (debenture rate) are guaranteed by the U.S. government; therefore, the risk of loss on these types of loans is very low. The Corporation does not consider loans with U.S. federal government guarantees to be impaired loans for the purpose of calculating the allowance for loan and lease losses.

Loan modifications that are considered TDRs completed during the quarter and nine-month period ended September 30, 2014 and 2013 were as follows:

(Dollars in thousands)	Quarter ended September 30, 2014					
	Number of contracts		Pre-modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
Troubled Debt Restructurings:						
Non-FHA/VA Residential Mortgage loans	88		\$ 13,050		\$ 12,856	
Commercial Mortgage Loans	1		589		589	
Commercial and Industrial Loans	4		76,110		76,182	
Construction Loans:						
Land	3		183		143	
Consumer Loans - Auto	214		3,189		3,106	
Finance Leases	13		292		230	
Consumer Loans - Other	352		1,756		1,758	
Total Troubled Debt Restructurings	675		\$ 95,169		\$ 94,864	
(Dollars in thousands)	Nine-Month period ended September 30, 2014					
	Number of contracts		Pre-modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
Troubled Debt Restructurings:						
Non-FHA/VA Residential Mortgage loans	226		\$ 31,776		\$ 30,831	
Commercial Mortgage Loans	5		1,833		1,836	
Commercial and Industrial Loans	16		105,188		104,926	
Construction Loans:						
Land	5		238		200	
Consumer Loans - Auto	423		6,202		6,104	
Finance Leases	33		659		565	
Consumer Loans - Other	1,094		5,172		5,147	
Total Troubled Debt Restructurings	1,802		\$ 151,068		\$ 149,609	


(Dollars in thousands)	Quarter ended September 30, 2013					
	Number of contracts		Pre-modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
Troubled Debt Restructurings:						
Non-FHA/VA Residential Mortgage loans	140		\$ 29,530		\$ 29,984	
Commercial Mortgage Loans	15		4,481		4,586	
Commercial and Industrial Loans	13		8,528		7,925	
Construction Loans:						
Land	3		133		136	
Consumer Loans - Auto	149		2,006		2,006	
Finance Leases	16		334		334	
Consumer Loans - Other	271		1,118		1,118	
Total Troubled Debt Restructurings	607		\$ 46,130		\$ 46,089	
(Dollars in thousands)	Nine-Month period ended September 30, 2013					
	Number of contracts		Pre-modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
Troubled Debt Restructurings:						
Non-FHA/VA Residential Mortgage loans	253		\$ 42,628		\$ 43,106	
Commercial Mortgage Loans	16		4,972		5,077	
Commercial and Industrial Loans	21		76,579		50,588	
Construction Loans:						
Land	7		341		344	
Construction-residential	1		195		195	
Consumer Loans - Auto	434		5,874		5,874	
Finance Leases	54		1,063		1,063	
Consumer Loans - Other	1,001		4,440		4,440	
Total Troubled Debt Restructurings	1,787		\$ 136,092		\$ 110,687	

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan, results in the loan once again becoming a non-performing loan. Recidivism occurs at a notably higher rate than do defaults on new origination loans, so modified loans present a higher risk of loss than do new origination loans. The Corporation considers a loan to have defaulted if the borrower has failed to make payments of either principal, interest, or both for a period of 90 days or more.

Loan modifications considered TDRs that defaulted during the quarters and nine-month periods ended September 30, 2014 and September 30, 2013 and had become TDRs during the 12-months preceding the default date were as follows:

(Dollars in thousands)	Quarter ended September 30,							
	2014				2013			
	Number of contracts		Recorded Investment		Number of contracts		Recorded Investment	
Non-FHA/VA Residential Mortgage loans	12		\$ 1,950		11		\$ 1,934	
Commercial Mortgage Loans	2		4,604		-		-	
Commercial and Industrial Loans	1		377		-		-	
Consumer Loans - Auto	21		347		-		-	
Consumer Loans - Other	64		262		-		-	
Finance Leases	4		82		1		18	
Total	104		\$ 7,622		12		\$ 1,952	

(Dollars in thousands)	Nine-Month Period Ended September 30,							
	2014				2013			
	Number of contracts		Recorded Investment		Number of contracts		Recorded Investment	
Non-FHA/VA Residential Mortgage loans	45		\$ 6,769		75		\$ 11,549	
Commercial Mortgage Loans	2		4,604		1		46,102	
Commercial and Industrial Loans	1		377		2		3,829	
Construction Loans:								
Land	1		46		2		66	
Construction-residential	-		-		1		186	
Consumer Loans - Auto	43		672		7		54	

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements



Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Consumer Loans - Other	162			643		40			219
Finance Leases	4			82		3			38
Total	258		\$	13,193		131		\$	62,043

For certain TDRs, the Corporation splits the loans into two new notes, A and B notes. The A note is restructured to comply with the Corporation's lending standards at current market rates, and is tailored to suit the customer's ability to make timely interest and principal payments. The B note includes the granting of the concession to the borrower and varies by situation. The B note is charged off but the obligation is not forgiven to the borrower, and any payments collected are accounted for as recoveries. At the time of restructuring, the A note is identified and classified as a TDR. If the loan performs for at least six months according to the modified terms, the A note may be returned to accrual status. The borrower's payment performance prior to the restructuring is included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring. In the periods following the calendar year in which a loan is restructured, the A note may no longer be reported as a TDR if it is on accrual, is in compliance with its modified terms, and yields a market rate (as determined and documented at the time of the restructuring).

The recorded investment in loans held for investment restructured using the A/B note restructure workout strategy was approximately \$59.8 million at September 30, 2014. The following table provides additional information about the volume of this type of loan restructuring and the effect on the allowance for loan and lease losses in the first nine months of 2014 and 2013:

	September 30, 2014		September 30, 2013	
(In thousands)				
Principal balance deemed collectible at end of period	\$	59,764	\$	90,914
Amount (recovery) charged off	\$	(7,732)	\$	25,389
(Reductions) charges to the provision for loan losses	\$	(8,719)	\$	567
Allowance for loan losses at end of period	\$	575	\$	1,588

Of the loans comprising the \$59.8 million that have been deemed collectible, approximately \$53.5 million were placed in accrual status as the borrowers have exhibited a period of sustained performance. These loans continue to be individually evaluated for impairment purposes.

## NOTE 7 – ALLOWANCE FOR LOAN AND LEASE LOSSES

The changes in the allowance for loan and lease losses were as follows:									
(In thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial & Industrial Loans	Construction Loans	Consumer Loans	Total			
<b>Quarter ended September 30, 2014</b>									
<b>Allowance for loan and lease losses:</b>									
Beginning balance	\$ 29,755	\$ 48,578	\$ 76,890	\$ 21,292	\$ 64,662	\$ 241,177			
Charge-offs	(5,970)	(2,823)	(17,605)	(7,691)	(19,848)	(53,937)			
Recoveries	236	3,939	1,174	4,486	1,360	11,195			
Provision (release)	5,885	2,721	3,017	(3,652)	19,028	26,999			
Ending balance	\$ 29,906	\$ 52,415	\$ 63,476	\$ 14,435	\$ 65,202	\$ 225,434			
Ending balance: specific reserve for impaired loans	\$ 11,658	\$ 14,128	\$ 21,267	\$ 2,936	\$ 5,295	\$ 55,284			
Ending balance: purchased credit-impaired loans	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -			
Ending balance: general allowance	\$ 18,248	\$ 38,287	\$ 42,209	\$ 11,499	\$ 59,907	\$ 170,150			
<b>Loans held for investment:</b>									
Ending balance	\$ 2,819,648	\$ 1,812,094	\$ 2,515,384	\$ 141,689	\$ 2,026,587	\$ 9,315,402			
	\$ 421,823	\$ 238,332	\$ 241,413	\$ 39,441	\$ 32,005	\$ 973,014			

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

Ending balance: impaired loans														
Ending balance: purchased credit-impaired loans	\$	99,535	\$	3,418	\$	-	\$	-	\$	1,360	\$	104,313		
Ending balance: loans with general allowance	\$	2,298,290	\$	1,570,344	\$	2,273,971	\$	102,248	\$	1,993,222	\$	8,238,075		
(In thousands)														
		<b>Residential Mortgage Loans</b>		<b>Commercial Mortgage Loans</b>		<b>Commercial &amp; Industrial Loans</b>		<b>Construction Loans</b>		<b>Consumer Loans</b>				<b>Total</b>
<b>Nine-Month period ended September 30, 2014</b>														
<b>Allowance for loan and lease losses:</b>														
Beginning balance	\$	33,110	\$	73,138	\$	85,295	\$	35,814	\$	58,501	\$	285,858		
Charge-offs		(17,379)		(22,056)		(59,516)		(11,322)		(56,425)		(166,698)		
Recoveries		605		8,271		2,253		5,158		4,329		20,616		
Provision (release)		13,570		(6,938)		35,444		(15,215)		58,797		85,658		
Ending balance	\$	29,906	\$	52,415	\$	63,476	\$	14,435	\$	65,202	\$	225,434		
Ending balance: specific reserve for impaired loans	\$	11,658	\$	14,128	\$	21,267	\$	2,936	\$	5,295	\$	55,284		
Ending balance: purchased credit-impaired loans	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-		
Ending balance: general allowance	\$	18,248	\$	38,287	\$	42,209	\$	11,499	\$	59,907	\$	170,150		

<b>Loans held for investment:</b>														
Ending balance	\$	2,819,648	\$	1,812,094	\$	2,515,384	\$	141,689	\$	2,026,587	\$	9,315,402		
Ending balance: impaired loans	\$	421,823	\$	238,332	\$	241,413	\$	39,441	\$	32,005	\$	973,014		
Ending balance: purchased credit-impaired loans	\$	99,535	\$	3,418	\$	-	\$	-	\$	1,360	\$	104,313		
Ending balance: loans with general allowance	\$	2,298,290	\$	1,570,344	\$	2,273,971	\$	102,248	\$	1,993,222	\$	8,238,075		

(In thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial & Industrial Loans	Construction Loans	Consumer Loans	Total
<b>Quarter ended September 30, 2013</b>						
<b>Allowance for loan and lease losses:</b>						
Beginning balance	\$ 35,581	\$ 88,013	\$ 87,677	\$ 34,728	\$ 55,048	\$ 301,047
Charge-offs	(8,698)	(5,944)	(7,419)	(1,824)	(15,559)	(39,444)
Recoveries	241	26	1,701	1,895	1,718	5,581
Provision (release)	4,663	(59)	1,090	1,304	15,197	22,195
Ending balance	\$ 31,787	\$ 82,036	\$ 83,049	\$ 36,103	\$ 56,404	\$ 289,379
Ending balance: specific reserve for impaired loans	\$ 17,982	\$ 28,316	\$ 34,438	\$ 21,785	\$ 3,654	\$ 106,175
Ending balance: purchased credit-impaired loans	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance: general allowance	\$ 13,805	\$ 53,720	\$ 48,611	\$ 14,318	\$ 52,750	\$ 183,204
<b>Loans held for investment:</b>						
Ending balance	\$ 2,519,457	\$ 1,857,794	\$ 2,908,347	\$ 163,610	\$ 2,059,426	\$ 9,508,634
Ending balance: impaired loans	\$ 397,025	\$ 205,654	\$ 200,285	\$ 73,482	\$ 28,063	\$ 904,509
Ending balance: purchased credit-impaired loans	\$ -	\$ -	\$ -	\$ -	\$ 5,963	\$ 5,963
Ending balance: loans	\$ 2,122,432	\$ 1,652,140	\$ 2,708,062	\$ 90,128	\$ 2,025,400	\$ 8,598,162

with general allowance																			
(In thousands)	<b>Residential Mortgage Loans</b>	<b>Commercial Mortgage Loans</b>	<b>Commercial &amp; Industrial Loans</b>	<b>Construction Loans</b>	<b>Consumer Loans</b>	<b>Total</b>													
<b>Nine-Month period ended September 30, 2013</b>																			
<b>Allowance for loan and lease losses:</b>																			
Beginning balance	\$ 68,354	\$ 97,692	\$ 146,900	\$ 61,600	\$ 60,868	\$ 435,414													
Charge-offs	(25,351)	(25,214)	(54,849)	(30,070)	(46,673)	(182,157)													
Charge-offs related to bulk sale	(98,972)	(40,057)	(44,678)	(12,784)	-	(196,491)													
Recoveries	868	64	3,460	2,042	5,397	11,831													
Provision	86,888	38,860	41,656	16,566	36,812	220,782													
Reclassification (1)	-	10,691	(9,440)	(1,251)	-	-													
Ending balance	\$ 31,787	\$ 82,036	\$ 83,049	\$ 36,103	\$ 56,404	\$ 289,379													
Ending balance: specific reserve for impaired loans	\$ 17,982	\$ 28,316	\$ 34,438	\$ 21,785	\$ 3,654	\$ 106,175													
Ending balance: purchased credit-impaired loans	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -													
Ending balance: general allowance	\$ 13,805	\$ 53,720	\$ 48,611	\$ 14,318	\$ 52,750	\$ 183,204													
<b>Loans held for investment:</b>																			
Ending balance	\$ 2,519,457	\$ 1,857,794	\$ 2,908,347	\$ 163,610	\$ 2,059,426	\$ 9,508,634													
Ending balance: impaired loans	\$ 397,025	\$ 205,654	\$ 200,285	\$ 73,482	\$ 28,063	\$ 904,509													
Ending	\$ -	\$ -	\$ -	\$ -	\$ 5,963	\$ 5,963													

balance: purchased credit-impaired loans														
Ending balance: loans with general allowance	\$	2,122,432	\$	1,652,140	\$	2,708,062	\$	90,128	\$	2,025,400	\$	8,598,162		
(1)	<p>During the second quarter of 2013, after a comprehensive review of substantially all of the loans in our commercial portfolios, the classification of certain loans was revised to more accurately depict the nature of the underlying loans. This reclassification resulted in a net increase of \$269.0 million in commercial mortgage loans, since the principal source of repayment for such loans is derived primarily from the operation of the underlying real estate, with a corresponding decrease of \$246.8 million in commercial and industrial loans and a \$22.2 million decrease in construction loans. The Corporation evaluated the impact of this reclassification on the provision for loan losses and determined that the effect of this adjustment was not material to any previously reported results.</p>													



During the second quarter of 2014, the Corporation made certain enhancements to the general allowance estimation process for commercial loans which mainly consisted of the following:

**Utilization of longer historical loss periods to better reflect the level of incurred losses in portfolio.** Historical charge-off rates are calculated by the Corporation on a quarterly basis by tracking cumulative charge-offs experienced over a two-year loss period on loans according to their internal risk rating (referred to as “base rate” for the quarter). Prior to the second quarter enhancements, the Corporation would use the base rate of the current quarter or the average of the last 4 quarters, if greater. During the second quarter of 2014, the Corporation eliminated the use of the “greater of” approach and adopted the utilization of the base rate average of the last 8 quarters. This change captures a longer historical period that would help mitigate period to period volatility in the loss rates.

**Enhancements of the environmental factors adjustment.** Prior to the second quarter of 2014 enhancements, these adjustments were applied in the form of basis points additions to the loss ratio based on changes in credit and economic indicators observed in the most recent periods. Beginning in the second quarter of 2014, the resulting factor derived from a set of risk-based ratings and weights assigned to credit and economic indicators activity over a reasonable period is now applied to a developed expected range of historical losses, in order to adjust the base rates. These enhancements result in a framework that can be applied more consistently, by having a more granular analysis that better captures trends in economic conditions and the impact in the Corporation’s portfolio.

In addition, the calculation of loss rates for asset classifications with limited or zero loss history was improved to consider these loans’ migration experience.

The Corporation maintained a parallel computation of the general reserve for commercial loans. The enhancements to the general allowance estimation process resulted in a net decrease to the allowance for loan losses of \$4.8 million as of the implementation date of May 31, 2014.

In the third quarter of 2014, similar enhancements to the environmental factors adjustment framework were applied to the consumer loans portfolio. The framework was defined for secured and unsecured loans to consider the specific behaviors separately. With respect to the historical charge-off rates, during the third quarter of 2014, the Corporation adopted the utilization of the base rate calculated as the average of net charge-off ratio for the 12 month period preceding the most recent four quarters. Previously, the base rate was calculated as the average of the last two years annual net charge-off ratio. The effect of these enhancements on the allowance for consumer loans was immaterial as of the implementation date of August 31, 2014.

The bulk sale of approximately \$217.7 million of adversely classified assets in the first quarter of 2013, mainly commercial loans, resulted in charge-offs of approximately \$98.5 million. In determining the historical loss rate for

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

the computation of the general reserve for commercial loans, the Corporation includes the portion of these charge-offs that was related to the acceleration of previously reserved credit losses amounting to approximately \$39.9 million. The Corporation considered that the portion not deemed to be credit-related losses was not indicative of the ultimate losses that may have occurred had the assets been resolved on an individual basis, over time and not in a steeply discounted bulk sale. A transaction, such as this one, entered into to expedite the reduction of non-performing and adversely classified assets, can result in charge-offs that are not reflective of true credit-related charge-off history since there is a component related to the discounted value realized on a bulk sale basis. Accordingly, the Corporation concluded that it is reasonable to exclude the component related to the discounted value from its historical charge-off analysis used in estimating its allowance for loan losses.

As of September 30, 2014, the Corporation maintained a \$0.2 million reserve for unfunded loan commitments mainly related to outstanding construction and commercial and industrial loan commitments. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments to borrowers that are experiencing financial difficulties at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition.

**NOTE 8 – LOANS HELD FOR SALE**

The Corporation's loans held-for-sale portfolio was composed of:

	September 30, 2014		December 31, 2013	
	(In thousands)			
Residential mortgage loans	\$	25,373	\$	21,168
Construction loans		47,802		47,802
Commercial mortgage loans		6,839		6,999
Total	\$	80,014	\$	75,969

Non-performing loans held for sale totaled \$54.6 million (\$6.8 million commercial mortgage and \$47.8 million construction loans) and \$54.8 million (\$7.0 million commercial mortgage and \$47.8 million construction loans) as of September 30, 2014 and December 31, 2013, respectively.

**NOTE 9 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

One of the market risks facing the Corporation is interest rate risk, which includes the risk that changes in interest rates will result in changes in the value of the Corporation's assets or liabilities and the risk that net interest income from its loan and investment portfolios will be adversely affected by changes in interest rates. The overall objective of the Corporation's interest rate risk management activities is to reduce the variability of earnings caused by changes in interest rates.

The Corporation designates a derivative as a fair value hedge, a cash flow hedge or an economic undesignated hedge when it enters into the derivative contract. As of September 30, 2014 and December 31, 2013, all derivatives held by the Corporation were considered economic undesignated hedges. These undesignated hedges are recorded at fair value with the resulting gain or loss recognized in current earnings.

The following summarizes the principal derivative activities used by the Corporation in managing interest rate risk:

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

Interest rate cap agreements - Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements for protection from rising interest rates.

Interest rate swaps - Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of September 30, 2014 and December 31, 2013, most of the interest rate swaps outstanding are used for protection against rising interest rates. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being economically hedged.

Forward Contracts - Forward contracts are sales of to-be-announced (“TBA”) mortgage-backed securities that will settle over the standard delivery date and do not qualify as “regular way” security trades. Regular-way security trades are contracts that have no net settlement provision and no market mechanism to facilitate net settlement and provide for delivery of a security within the time generally established by regulations or conventions in the market place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked to market. These securities are used to economically hedge the FHA/VA residential mortgage loan securitizations of the mortgage-banking operations. Unrealized gains (losses) are recognized as part of mortgage banking activities in the Consolidated Statements of Income (Loss).

To satisfy the needs of its customers, the Corporation may enter into nonhedging transactions. On these transactions, generally, the Corporation participates as a buyer in one of the agreements and as a seller in the other agreement under the same terms and conditions.

In addition, the Corporation may enter into certain contracts with embedded derivatives that do not require separate accounting as these are clearly and closely related to the economic characteristics of the host contract. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated, carried at fair value, and designated as a trading or non-hedging derivative instrument.

The following table summarizes the notional amounts of all derivative instruments:				
Notional Amounts				
As of		As of		
September 30,		December 31,		
2014		2013		
(In thousands)				
<b>Undesignated economic hedges:</b>				
Interest rate contracts:				
Interest rate swap agreements	\$	30,746	\$	31,080
Written interest rate cap agreements		37,453		38,391
Purchased interest rate cap agreements		37,453		38,391
Forward Contracts:				
Sale of TBA GNMA MBS pools		22,000		25,000
	\$	127,652	\$	132,862

Notional amounts are presented on a gross basis with no netting of offsetting exposure positions.

The following table summarizes the fair value of derivative instruments and the location in the statement of financial condition:											
Asset Derivatives					Liability Derivatives						
Statement of		September 30,		December 31,		Statement of		September 30,		December 31,	
Financial		2014		2013		Financial		2014		2013	
Condition Location		Fair Value		Fair Value		Condition Location		Fair Value		Fair Value	
(In thousands)											
<b>Undesignated economic hedges:</b>											
Interest rate contracts:											
Interest rate swap agreements	Other assets	\$	67	\$	162	Accounts payable and other liabilities	\$	2,877	\$	3,965	
Written interest rate cap agreements	Other assets		-		-	Accounts payable and other liabilities		18		58	
Purchased interest rate cap agreements	Other assets		18		58	Accounts payable and other liabilities		-		-	

Forward Contracts:														
Sales of TBA GNMA MBS pools	Other assets		17			174		Accounts payable and other liabilities			16			-
		\$	102		\$	394			\$	2,911		\$	4,023	

The following table summarizes the effect of derivative instruments on the statement of income (loss):													
		Gain (or Loss)						Gain (or Loss)					
		Quarter Ended						Nine-Month Period Ended					
		September 30,						September 30,					
(In thousands)	Location of Gain or (loss) Recognized in Income on Derivatives	2014			2013			2014			2013		
(In thousands)													
<b>Undesignated economic hedges:</b>													
Interest rate contracts:													
Interest rate swap agreements used to hedge fixed-rate loans	Interest income - Loans	\$	419	\$	232	\$	993	\$	1,331				
Written and purchased interest rate cap agreements	Interest income - Loans		-		-		-		9				
Forward contracts:													
Sales of TBA GNMA MBS pools	Mortgage banking activities		229		(1,444)		(173)		(578)				
Total gain on derivatives		\$	648	\$	(1,212)	\$	820	\$	762				

Derivative instruments, such as interest rate swaps, are subject to market risk. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future.

A summary of interest rate swaps follows:

		As of			As of		
		September 30,			December 31,		
		2014			2013		
(Dollars in thousands)							
Pay fixed/receive floating :							

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Notional amount	\$	30,746		\$	31,080	
Weighted-average receive rate at period end		1.84%			1.85%	
Weighted-average pay rate at period end		6.77%			6.77%	
Floating rates range from 167 to 187 basis points over 3-month LIBOR						
As of September 30, 2014, the Corporation has not entered into any derivative instrument containing credit-risk related contingent features.						



**NOTE 10 – OFFSETTING OF ASSETS AND LIABILITIES**

The Corporation enters into master agreements with counterparties that may allow for netting of exposures in the event of default, primarily related to derivatives and repurchase agreements. In an event of default, each party has a right of set-off against the other party for the amounts owed in the related agreement and any other amount or obligation owed in respect of any other agreement or transaction between them. The following table presents information about the offsetting of financial assets and liabilities as well as derivative assets and liabilities:

Offsetting of Financial Assets and Derivative Assets										
(In thousands)										
As of September 30, 2014										
Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position				Net Amount		
				Financial Instruments	Cash Collateral					
Derivatives	\$ 18	\$ -	\$ 18	\$ (18)	\$ -			\$ -		
As of December 31, 2013										
Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position				Net Amount		
				Financial Instruments	Cash Collateral					

Description	Assets		Statement of Financial Position		Statement of Financial Position						Amount	
Derivatives	\$	58	\$	-	\$	58	\$	(58)	\$	-	\$	-
					49							

<b>Offsetting of Financial Liabilities and Derivative Liabilities</b>									
(In thousands)									
<b>As of September 30, 2014</b>									
						<b>Gross Amounts Not Offset in the Statement of Financial Position</b>			
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Financial Instruments		Cash Collateral		Net Amount	
<b>Description</b>									
Derivatives	\$ 2,877	\$ -	\$ 2,877	\$ (2,877)	\$ -	\$ -	\$ -	\$ -	\$ -
Repurchase agreements	600,000	-	600,000	(600,000)	-	-	-	-	-
Total	\$ 602,877	\$ -	\$ 602,877	\$ (602,877)	\$ -	\$ -	\$ -	\$ -	\$ -
<b>As of December 31, 2013</b>									
						<b>Gross Amounts Not Offset in the Statement of Financial Position</b>			
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Financial Instruments		Cash Collateral		Net Amount	
<b>Description</b>									

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Derivatives	\$	3,965	\$	-	\$	3,965	\$	(3,965)	\$	-	\$	-
Repurchase agreements		600,000		-		600,000		(600,000)		-		-
Total	\$	603,965	\$	-	\$	603,965	\$	(603,965)	\$	-	\$	-

**NOTE 11 – GOODWILL AND OTHER INTANGIBLES**

Goodwill as of September 30, 2014 and December 31, 2013 amounted to \$28.1 million, recognized as part of “Other Assets” in the consolidated statement of financial condition. The Corporation conducted its annual evaluation of goodwill and intangibles during the fourth quarter of 2013.

The Corporation bypassed the qualitative assessment in 2013 and proceeded directly to perform the first step of the two-step goodwill impairment test. The Step 1 evaluation of goodwill allocated to the Florida reporting unit under both valuation approaches (market and discounted cash flow analysis) indicated that the fair value of the unit was above the carrying amount of its equity book value as of the valuation date (October 1); therefore, the completion of Step 2 was not required. Based on the analysis under both the market and discounted cash flow analysis, the estimated fair value of the equity of the reporting unit exceeded the carrying amount of the entity, including goodwill at the evaluation date. There have been no events related to the Florida reporting unit that could indicate potential goodwill impairment since the date of the last evaluation; therefore, no goodwill impairment evaluation was performed during the first nine months of 2014. Goodwill and other indefinite life intangibles are reviewed at least annually for impairment.

In connection with the acquisition of the FirstBank-branded credit card loan portfolio in the second quarter of 2012, the Corporation recognized a purchased credit card relationship intangible of \$24.5 million, which is being amortized over 7.3 years on an accelerated basis based on the estimated attrition rate of the purchased credit card accounts, which reflects the pattern in which the economic benefits of the intangible asset are consumed. These benefits are consumed as the revenue stream generated by the cardholder relationship is realized.

The following table shows the gross amount and accumulated amortization of the Corporation’s intangible assets recognized as part of Other Assets in the consolidated statement of financial condition:				
	As of		As of	
	September 30,		December 31,	
	2014		2013	
(Dollars in thousands)				
<b>Core deposit intangible:</b>				
Gross amount	\$	45,844	\$	45,844
Accumulated amortization		(40,034)		(38,863)
Net carrying amount	\$	5,810	\$	6,981
Remaining amortization period		8.7 years		9.8 years
<b>Purchased credit card relationship intangible:</b>				
Gross amount	\$	24,465	\$	24,465
Accumulated amortization		(7,230)		(4,678)

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

Net carrying amount	\$	17,235		\$	19,787
Remaining amortization period		7.3 years			8.0 years

For the quarter and nine-month period ended September 30, 2014, the amortization expense of core deposit intangibles amounted to \$0.4 million and \$1.2 million, respectively (2013 - \$0.6 million and \$1.8 million, respectively). For the quarter and nine-month period ended September 30, 2014, the amortization expense of the purchased credit card relationship intangible amounted to \$0.8 million and \$2.6 million, respectively (2013 - \$0.9 million and \$2.8 million, respectively).

## NOTE 12 – NON CONSOLIDATED VARIABLE INTEREST ENTITIES AND SERVICING ASSETS

The Corporation transfers residential mortgage loans in sale or securitization transactions in which it has continuing involvement, including servicing responsibilities and guarantee arrangements. All such transfers have been accounted for as sales as required by applicable accounting guidance.

When evaluating transfers and other transactions with Variable Interest Entities (“VIEs”) for consolidation, the Corporation first determines if the counterparty is an entity for which a variable interest exists. If no scope exception is applicable and a variable interest exists, the Corporation then evaluates if it is the primary beneficiary of the VIE and whether the entity should be consolidated or not.

Below is a summary of transfers of financial assets to VIEs for which the Corporation has retained some level of continuing involvement:

### Ginnie Mae

The Corporation typically transfers first lien residential mortgage loans in conjunction with GNMA securitization transactions in which the loans are exchanged for cash or securities that are readily redeemed for cash proceeds and servicing rights. The securities issued through these transactions are guaranteed by the issuer and, as such, under seller/servicer agreements, the Corporation is required to service the loans in accordance with the issuers’ servicing guidelines and standards. As of September 30, 2014, the Corporation serviced loans securitized through GNMA with a principal balance of \$1.1 billion.

### Trust Preferred Securities

In 2004, FBP Statutory Trust I, a financing subsidiary of the Corporation, sold to institutional investors \$100 million of its variable rate trust-preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase \$103.1 million aggregate principal amount of the Corporation’s Junior Subordinated Deferrable Debentures. Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly owned by the Corporation, sold to institutional investors \$125 million of its variable rate trust-preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase \$128.9 million aggregate principal amount of the Corporation’s Junior Subordinated Deferrable Debentures. The debentures are presented in the

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

Corporation's consolidated statement of financial condition as Other Borrowings, net of related issuance costs. The variable rate trust-preferred securities are fully and unconditionally guaranteed by the Corporation. The \$100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the \$125 million issued in September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Deferrable Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust-preferred securities). The trust-preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current applicable rules and regulations. The Collins Amendment to the Dodd-Frank Act eliminates certain trust-preferred securities from Tier 1 Capital. Bank Holding Companies, such as the Corporation, must fully phase out these instruments from Tier I capital by January 1, 2016 (25% allowed in 2015 and 0% in 2016); however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature. The Corporation elected to defer the interest payments that were due in quarterly periods since March 2012. The aggregate amount of payments deferred and accrued approximates \$20.1 million as of September 30, 2014. Under the indentures, the Corporation has the right, from time to time, and without causing an event of default, to defer payments of interest on the subordinated debentures by extending the interest payment period at any time and from time to time during the term of the subordinated debentures for up to twenty consecutive quarterly periods. Future interest payments are subject to the Federal Reserve approval.

#### Grantor Trusts

During 2004 and 2005, a third party to the Corporation, from now on identified as the seller, established a series of statutory trusts to effect the securitization of mortgage loans and the sale of trust certificates. The seller initially provided the servicing for a fee, which is senior to the obligations to pay trust certificate holders.



The seller then entered into a sales agreement through which it sold and issued the trust certificates in favor of the Corporation's banking subsidiary. Currently, the Bank is the sole owner of the trust certificates; the servicing of the underlying residential mortgages that generate the principal and interest cash flows is performed by another third party, which receives a servicing fee. The securities are variable rate securities indexed to 90-day LIBOR plus a spread. The principal payments from the underlying loans are remitted to a paying agent (servicer) who then remits interest to the Bank; interest income is shared to a certain extent with the FDIC, which has an interest only strip ("IO") tied to the cash flows of the underlying loans and is entitled to receive the excess of the interest income less a servicing fee over the variable rate income that the Bank earns on the securities. This IO is limited to the weighted average coupon of the securities. The FDIC became the owner of the IO upon the intervention of the seller, a failed financial institution. No recourse agreement exists and the risk from losses on non accruing loans and repossessed collateral is absorbed by the Bank as the sole holder of the certificates. As of September 30, 2014, the amortized balance and carrying value of Grantor Trusts amounted to \$48.8 million and \$36.0 million, respectively, with a weighted average yield of 2.17%.

#### Investment in unconsolidated entity

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and commercial and industrial loans with an aggregate book value of \$269.3 million to CPG/GS, an entity organized under the laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC ("PRLP"), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received \$88.5 million in cash and a 35% interest in CPG/GS, and made a loan in the amount of \$136.1 million representing seller financing provided by FirstBank. The loan had a seven-year maturity and bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity's assets as well as the PRLP's 65% ownership interest in CPG/GS. As of September 30, 2014, the carrying amount of the loan was \$37.2 million, which was included in the Corporation's Commercial and Industrial loans held for investment portfolio. FirstBank's equity interest in CPG/GS is accounted for under the equity method and included as part of Investment in unconsolidated entity in the Consolidated Statements of Financial Condition. When applying the equity method, the Bank follows the Hypothetical Liquidation Book Value method ("HLBV") to determine its share of CPG/GS's earnings or loss. Under HLBV, the Bank determines its share of CPG/GS's earnings or loss by determining the difference between its "claim on CPG/GS's book value" at the end of the period as compared to the beginning of the period. This claim is calculated as the amount the Bank would receive if CPG/GS were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to the investors, PRLP and FirstBank, according to their respective priorities as provided in the contractual agreement. The Bank reports its share of CPG/GS's operating results on a one-quarter lag basis. In addition, as a result of using HLBV, the difference between the Bank's investment in CPG/GS and its claim on the book value of CPG/GS at the date of the investment, known as the basis difference, is amortized over the estimated life of the investment, or five years. CPG/GS records its loans receivable under the fair value option. Equity in loss of unconsolidated entity for the nine month period ended September 30, 2014 of \$7.3 million includes \$1.8 million related to the amortization of the basis differential, compared to equity in loss of unconsolidated entity of \$10.8 million for the first nine months of 2013. The loss recorded in 2014 reduced to zero the carrying amount of the Bank's investment in CPG/GS. No negative investment needs to be reported as the Bank has no legal obligation or commitment to provide further financial support to this entity; thus, no further losses will be recorded on this investment. Any potential increase in the carrying value of the investment in CPG/GS, under the HLBV method, would depend upon how better off the Bank is at the end of the period than it was at the beginning of the period after the waterfall calculation performed to determine the amount of

gain allocated to the investors.

FirstBank also provided an \$80 million advance facility to CPG/GS to fund unfunded commitments and costs to complete projects under construction, which was fully disbursed in 2011, and a \$20 million working capital line of credit to fund certain expenses of CPG/GS. During 2013, the working capital line of credit was renewed and reduced to \$7 million for a period of two years expiring September 2015.

During 2012, CPG/GS repaid the outstanding balance of the advance facility to fund unfunded commitments, and the funds became available to redraw under a one-time revolver agreement. These loans bear variable interest at 30-day LIBOR plus 300 basis points. As of September 30, 2014, the carrying value of the revolver agreement and working capital line was \$37.6 million and \$0, respectively, which was included in the Corporation's commercial and industrial loans held for investment portfolio.

Cash proceeds received by CPG/GS are first used to cover operating expenses and debt service payments, including the note receivable, the advance facility, and the working capital line, described above, which must be substantially repaid before proceeds can be used for other purposes, including the return of capital to both PRLP and FirstBank. FirstBank will not receive any return on its equity interest until PRLP receives an aggregate amount equivalent to its initial investment and a priority return of at least 12%, resulting in FirstBank's interest in CPG/GS being subordinate to PRLP's interest. CPG/GS will then begin to make payments pro rata to PRLP and FirstBank, 35% and 65%, respectively, until FirstBank has achieved a 12% return on its invested capital and the aggregate amount of distributions is equal to FirstBank's capital contributions to CPG/GS.

The Bank has determined that CPG/GS is a VIE in which the Bank is not the primary beneficiary. In determining the primary beneficiary of CPG/GS, the Bank considered applicable guidance that requires the Bank to qualitatively assess the determination of the primary beneficiary (or consolidator) of CPG/GS based on whether it has both the power to direct the activities of CPG/GS that most significantly impact the entity's economic performance and the obligation to absorb losses of CPG/GS that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

The Bank determined that it does not have the power to direct the activities that most significantly impact the economic performance of CPG/GS as it does not have the right to manage the loan portfolio, impact foreclosure proceedings, or manage the construction and sale of the property; therefore, the Bank concluded that it is not the primary beneficiary of CPG/GS. As a creditor to CPG/GS, the Bank has certain rights related to CPG/GS; however, these are intended to be protective in nature and do not provide the Bank with the ability to manage the operations of CPG/GS. Since CPG/GS is not a consolidated subsidiary of the Bank and the transaction met the criteria for sale accounting under authoritative guidance, the Bank accounted for this transaction as a true sale, recognizing the cash received, the notes receivable, and the interest in CPG/GS and derecognizing the loan portfolio sold.

The following table shows summarized unaudited income statement information of CPG/GS for the quarters and nine-month periods ended September 30, 2014 and 2013:									
Quarter Ended					Nine-Month Period Ended				
September 30,		September 30,			September 30,		September 30,		
2014		2013			2014		2013		
(In thousands)					(In thousands)				

Revenues, including net realized gains on sale of											
investments in loans and OREO	\$	375		\$	526		\$	3,244		\$	2,245
Gross (loss) profit	\$	(2,347)		\$	(2,889)		\$	(4,310)		\$	(6,557)
Net loss	\$	(2,976)		\$	(3,709)		\$	(7,778)		\$	(1,516)

#### Servicing Assets

The Corporation is actively involved in the securitization of pools of FHA-insured and VA-guaranteed mortgages for issuance of GNMA mortgage-backed securities. Also, certain conventional conforming loans are sold to FNMA or FHLMC with servicing retained. The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased.

The changes in servicing assets are shown below:											
						Quarter ended			Nine-Month period ended		
						September 30,			September 30,		
						2014		2013	2014		2013
(In thousands)											
Balance at beginning of period	\$	22,270		\$	19,979		\$	21,987		\$	17,524
Capitalization of servicing assets		1,075			2,653			3,144			6,467
Amortization		(772)			(765)			(2,345)			(2,351)
Adjustment to fair value		(46)			32			(226)			589
Other (1)		(24)			(14)			(57)			(344)
Balance at end of period	\$	22,503		\$	21,885		\$	22,503		\$	21,885
(1)	Amount represents the adjustment to fair value related to the repurchase of loans serviced for others.										

Impairment charges are recognized through a valuation allowance for each individual stratum of servicing assets. The valuation allowance is adjusted to reflect the amount, if any, by which the cost basis of the servicing asset for a given stratum of loans being serviced exceeds its fair value. Any fair value in excess of the cost basis of the servicing asset for a given stratum is not recognized.

Changes in the impairment allowance related to servicing assets were as follows:											
						Quarter ended			Nine-Month Period Ended		
						September 30,			September 30,		
						2014		2013	2014		2013
(In thousands)											
Balance at beginning of period	\$	392		\$	115		\$	212		\$	672
Temporary impairment charges		53			32			296			147
OTTI of servicing assets		(385)			-			(385)			-
Recoveries		(7)			(64)			(70)			(736)
Balance at end of period	\$	53		\$	83		\$	53		\$	83

The components of net servicing income are shown below:											
						Quarter ended			Nine-Month Period Ended		
						September 30,			September 30,		

	2014		2013		2014		2013	
	<b>(In thousands)</b>							
Servicing fees	\$	1,738	\$	1,900	\$	5,098	\$	5,513
Late charges and prepayment penalties		177		101		518		532
Adjustment for loans repurchased		(24)		(14)		(57)		(344)
Other (1)		(197)		(273)		(1,244)		(421)
Servicing income, gross		1,694		1,714		4,315		5,280
Amortization and impairment of servicing assets		(818)		(733)		(2,571)		(1,762)
Servicing income, net	\$	876	\$	981	\$	1,744	\$	3,518
(1)	Mainly consisted of compensatory fees imposed by GSEs and losses related to representations and warranties.							

The Corporation's servicing assets are subject to prepayment and interest rate risks. Key economic assumptions used in determining the fair value at the time of sale ranged as follows:						
	Maximum			Minimum		
<b>Nine-Month Period Ended September 30, 2014:</b>						
<b>Constant prepayment rate:</b>						
Government guaranteed mortgage loans	9.6	%		9.1	%	
Conventional conforming mortgage loans	9.4	%		8.9	%	
Conventional non-conforming mortgage loans	13.8	%		12.7	%	
<b>Discount rate:</b>						
Government guaranteed mortgage loans	11.5	%		11.5	%	
Conventional conforming mortgage loans	9.5	%		9.5	%	
Conventional non-conforming mortgage loans	13.9	%		13.8	%	
<b>Nine-Month Period Ended September 30, 2013:</b>						
<b>Constant prepayment rate:</b>						
Government guaranteed mortgage loans	10.5	%		9.1	%	
Conventional conforming mortgage loans	10.9	%		9.2	%	
Conventional non-conforming mortgage loans	14.3	%		13.0	%	
<b>Discount rate:</b>						
Government guaranteed mortgage loans	12.0	%		11.5	%	
Conventional conforming mortgage loans	10.0	%		9.5	%	
Conventional non-conforming mortgage loans	14.3	%		13.8	%	

As of September 30, 2014, fair values of the Corporation's servicing assets were based on a valuation model that incorporates market driven assumptions regarding discount rates and mortgage prepayment rates, adjusted by the particular characteristics of the Corporation's servicing portfolio. The weighted-averages of the key economic assumptions used by the Corporation in its valuation model and the sensitivity of the current aggregate fair value to immediate 10% and 20% adverse changes in those assumptions for mortgage loans as of September 30, 2014 were as follows:

	(Dollars in thousands)		
Carrying amount of servicing assets	\$	22,503	
Fair value	\$	25,565	
Weighted-average expected life (in years)		9.15	
<b>Constant prepayment rate (weighted-average annual rate)</b>		9.71%	
Decrease in fair value due to 10% adverse change	\$	934	
Decrease in fair value due to 20% adverse change	\$	1,812	

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

<b>Discount rate (weighted-average annual rate)</b>		10.63%	
Decrease in fair value due to 10% adverse change	\$	1,085	
Decrease in fair value due to 20% adverse change	\$	2,087	

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship between the change in assumption and the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the servicing asset is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or counteract the sensitivities.



## NOTE 13 – DEPOSITS

The following table summarizes deposit balances:					
		<b>September 30,</b>			<b>December 31,</b>
		<b>2014</b>			<b>2013</b>
		<b>(In thousands)</b>			
Type of account:					
Non-interest bearing checking accounts	\$	862,422		\$	851,212
Savings accounts		2,506,127			2,334,831
Interest-bearing checking accounts		1,057,775			1,167,480
Certificates of deposit		2,213,070			2,384,378
Brokered CDs		3,063,780			3,142,023
	\$	9,703,174		\$	9,879,924

Brokered CDs mature as follows:		
		<b>September 30,</b>
		<b>2014</b>
		<b>(In thousands)</b>
Three months or less	\$	476,868
Over three months to six months		372,529
Over six months to one year		949,776
One to three years		1,114,067
Three to five years		114,523
Over five years		36,017
Total	\$	3,063,780

The following are the components of interest expense on deposits:										
		<b>Quarter Ended</b>				<b>Nine-Month Period Ended</b>				
		<b>September 30,</b>				<b>September 30,</b>				
		<b>2014</b>		<b>2013</b>		<b>2014</b>			<b>2013</b>	
		<b>(In thousands)</b>				<b>(In thousands)</b>				
Interest expense on deposits	\$	17,705		\$	19,541	\$	53,969		\$	64,821
Amortization of broker placement fees		1,639			1,912		5,140			6,094

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

Interest expense on deposits	\$	19,344		\$	21,453	\$	59,109	\$	70,915
------------------------------	----	--------	--	----	--------	----	--------	----	--------

**NOTE 14 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

Securities sold under agreements to repurchase (repurchase agreements) consist of the following:					
		<b>September 30,</b>		<b>December 31,</b>	
		<b>2014 (1)</b>		<b>2013</b>	
<b>(Dollars in thousands)</b>					
Repurchase agreements, interest rates ranging from 2.45% to 4.50%					
(December 31, 2013 - 2.45% to 3.32%)		\$	900,000	\$	900,000
(1)	As of September 30, 2014, includes \$800 million with an average rate of 3.07% that lenders have the right to call before their contractual maturities at various dates beginning on October 9, 2014. Subsequent to September 30, 2014, no lender has exercised its call option on repurchase agreements. In addition, \$600 million of the \$900 million is tied to variable rates.				

Repurchase agreements mature as follows:			
			<b>September 30, 2014</b>
			<b>(In thousands)</b>
	Over one year to three years	\$	600,000
	Three to five years		300,000
	Total	\$	900,000

As of September 30, 2014 and December 31, 2013, the securities underlying such agreements were delivered to the dealers with which the repurchase agreements were transacted.

Repurchase agreements as of September 30, 2014, grouped by counterparty, were as follows:					
(Dollars in thousands)					<b>Weighted-Average</b>
<b>Counterparty</b>		<b>Amount</b>		<b>Maturity (In Months)</b>	

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

	Citigroup Global Markets		\$	300,000		25
	JP Morgan Chase			200,000		29
	Dean Witter / Morgan Stanley			100,000		37
	Credit Suisse First Boston			300,000		39
			\$	900,000		

**NOTE 15 – ADVANCES FROM THE FEDERAL HOME LOAN BANK (FHLB)**

The following is a summary of the advances from the FHLB:						
		September 30,			December 31,	
		2014			2013	
(Dollars in thousands)						
	Fixed-rate advances from FHLB, with a weighted-					
	average interest rate of 1.17% (December 31, 2013 - 1.07%)	\$	325,000		\$	300,000

Advances from FHLB mature as follows:			
		September 30,	
		2014	
(In thousands)			
	Over one year to three years		300,000
	Over three years		25,000
	Total	\$	325,000

As of September 30, 2014, the Corporation had additional capacity of approximately \$371.8 million on this credit facility based on collateral pledged at the FHLB, including a haircut reflecting the perceived risk associated with holding the collateral.

**NOTE 16 – OTHER BORROWINGS**

Other borrowings consist of:

		September 30,	December 31,
		2014	2013

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

	(In thousands)			
Junior subordinated debentures due in 2034,				
interest-bearing at a floating rate of 2.75%				
over 3-month LIBOR (2.98% as of September 30, 2014				
and 2.99% as of December 31, 2013)	\$	103,093	\$	103,093
Junior subordinated debentures due in 2034,				
interest-bearing at a floating rate of 2.50%				
over 3-month LIBOR (2.73% as of September 30, 2014				
and 2.75% as of December 31, 2013)		128,866		128,866
	\$	231,959	\$	231,959

## NOTE 17 – STOCKHOLDERS' EQUITY

### *Common Stock*

As of September 30, 2014 and December 31, 2013, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of \$0.10 per share. As of September 30, 2014 and December 31, 2013, there were 213,642,311 and 207,635,157 shares issued, respectively, and 212,977,588 and 207,068,978 shares outstanding, respectively. On July 30, 2009, the Corporation announced the suspension of common and preferred stock dividends effective with the preferred dividend for the month of August 2009.

During the first nine months of 2014, the Corporation awarded 379,573 shares of restricted stock under the Omnibus Plan to the independent directors, subject to vesting periods ranging from one year to five years. Also in the first nine months of 2014, the Corporation granted 840,138 shares of restricted stock to certain senior officers and certain other employees. The restrictions on such restricted stock will lapse with respect to 50% over a two-year period and 50% over a three-year period. Included in the 840,138 shares of restricted stock are 653,138 shares granted to certain senior officers consistent with the requirements of TARP. In addition, in 2014, the Corporation issued 224,162 shares of common stock as increased compensation to certain executive officers. As of September 30, 2014 and December 31, 2013, there were 2,477,218 and 1,411,185 shares of unvested restricted stock outstanding, respectively. During the first nine months of 2014, 33,840 shares of restricted stock were forfeited and the restrictions on 119,838 shares of restricted stock lapsed. Refer to Note 3 for additional details.

On September 9, 2014, the U.S. Department of Treasury announced that it would continue to wind down its investment in First BanCorp. by selling additional shares of common stock through its first pre-defined written trading plan. As of the announcement date, the U.S. Treasury held 19,680,441 shares, or approximately 9.2% of First BanCorp.'s common stock. Back in 2013, the U.S. Treasury sold 13,261,356 shares of First BanCorp.'s common stock at \$6.75 per share in a registered offering.

### *Preferred Stock*

The Corporation has 50,000,000 authorized shares of preferred stock with a par value of \$1, redeemable at the Corporation's option subject to certain terms. This stock may be issued in series and the shares of each series will have such rights and preferences as are fixed by the Board of Directors when authorizing the issuance of that particular series. As of September 30, 2014, the Corporation has five outstanding series of non-convertible, non-cumulative preferred stock: 7.125% non-cumulative perpetual monthly income preferred stock, Series A; 8.35% non-cumulative perpetual monthly income preferred stock, Series B; 7.40% non-cumulative perpetual monthly income preferred stock, Series C; 7.25% non-cumulative perpetual monthly income preferred stock, Series D; and 7.00%

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

non-cumulative perpetual monthly income preferred stock, Series E. The liquidation value per share is \$25.

Effective January 17, 2012, the Corporation delisted all of its outstanding series of non-convertible, non-cumulative preferred stock from the New York Stock Exchange. The Corporation has not arranged for listing and/or registration on another national securities exchange or for quotation of the Series A through E Preferred Stock in a quotation medium.

In the first nine months of 2014, the Corporation issued an aggregate of 4,597,121 shares of its common stock in exchange for an aggregate of 1,077,726 shares of the Corporation's Series A through E Preferred Stock, having an aggregate liquidation value of \$26.9 million. The shares of common stock were issued to holders of the Series A through E Preferred Stock in separate and unrelated transactions in reliance upon the exemption set forth in Section 3(a)(9) of the Securities Act of 1933, as amended, for securities exchanged by an issuer with existing security holders where no commission or other remuneration is paid or given directly or indirectly by the issuer for soliciting such exchange. The exchange resulted in a decrease in the carrying (liquidation) value of the Series A through E preferred stock of \$26.9 million, and common stock and additional paid-in capital was increased in the amount of the fair value of the common stock issued. The Corporation recorded the par value of the shares issued as common stock (\$0.10 per common share) or \$0.5 million. The excess of the common stock fair value over the par value, or \$23.9 million, was recorded in additional paid-in capital. The excess of the carrying amount of the shares of preferred stock over the fair value of the shares of common stock, or \$1.7 million, was recorded as an increase to retained earnings and an increase in earnings per common share computation.



The results of the exchange with respect to Series A through E preferred stock were as follows:										
				Shares of		Shares of		Aggregate		
				preferred		preferred		liquidation		
				stock	Shares of	stock		preference	Shares of	
		Liquidation	outstanding	preferred	outstanding	after		after	common	
		preference	prior to	stock	after	exchange		exchange	stock	
		per share	exchange	exchanged	exchange	(in		thousands)	issued	
<b>Title of Securities</b>										
7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A	\$	25	450,195	252,809	197,386	\$	4,935	1,081,652		
8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B	\$	25	475,987	179,841	296,146		7,404	769,379		
7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C	\$	25	460,611	210,759	249,852		6,246	890,830		
7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D	\$	25	510,592	225,070	285,522		7,138	961,724		

7.00% Noncumulative Perpetual													
Monthly Income Preferred													
Stock, Series E	\$	25	624,487	209,247	415,240			10,381	893,536				
			2,521,872	1,077,726	1,444,146		\$	36,104	4,597,121				

### *Treasury stock*

During the first nine months of 2014, the Corporation withheld an aggregate of 98,544 shares of the common stock paid to certain senior officers as additional compensation and of the restricted stock that vested during 2014 to cover employees' payroll and income tax withholding liabilities; these shares are also held as treasury shares. As of September 30, 2014 and December 31, 2013, the Corporation had 664,723 and 566,179 shares held as treasury stock, respectively.

### *FirstBank Statutory Reserve (Legal Surplus)*

The Banking Law of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to legal surplus until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the stockholders without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The net loss experienced in 2013 exhausted FirstBank's statutory reserve fund. The Puerto Rico Banking Law provides that when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts shall be charged against the undistributed profits of the bank, and the balance, if any, shall be charged against the reserve fund, as a reduction thereof. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount shall be charged against the capital account and the Bank cannot pay dividends until it can replenish the reserve fund to an amount of at least 20% of the original capital contributed.

## NOTE 18 - INCOME TAXES

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp. is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 PR Code"), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a NOL, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

On June 30, 2013, the Puerto Rico Government approved Act No. 40 ("Act 40"), known as the "Tax Burden Adjustment and Redistribution Act", which amended the 2011 PR Code, and Act No. 46 ("Act 46"), which enacted changes to the sales and use tax regime. The main provisions of Act 40 that impact financial institutions are:

(i) A new national gross receipts tax that in the case of financial institutions is 1% of gross income that is not deductible for purposes of computing net taxable income and is not part of the alternative minimum tax ("AMT"). This provision was retroactive to January 1, 2013. The national gross receipts tax expense for the quarter and nine-month period ended September 30, 2014 amounted to \$1.4 million and \$4.3 million, respectively, compared to \$1.7 million and \$4.9 million recorded for the third quarter and first nine months of 2013, respectively. This expense is included as part of "Taxes, other than income taxes" in the consolidated statement of income (loss). Subject to certain limitations, a financial institution will be able to claim a credit of 0.5% of its gross income against its regular income tax or the AMT. A benefit related to this credit of \$0.7 million and \$2.1 million was recorded as a reduction to the provision for income taxes in the third quarter and first nine months of 2014, respectively, compared to the benefit of \$0.8 million and \$2.5 million recorded in the third quarter and first nine months of 2013, respectively.

(ii) A decrease in the deduction available to corporations for the computation of the additional surtax from \$750,000 to \$25,000 and a change in the surtax rate to rates that range from 5% to 19%, resulting in an increase in the maximum statutory tax rate from 30% to 39%. This provision was also retroactive to January 1, 2013.

(iii) A higher AMT rate (30% of the alternative minimum net income, as compared to 20% previously) and various parallel computations required to be made before determining whether an AMT liability exists.

(iv) The NOL carryover period increased from 10 years to 12 years for losses incurred in taxable years that commenced after December 31, 2004 and ended before January 1, 2013. The carryover period for NOLs incurred during taxable years commencing after December 31, 2012 is 10 years. The NOL deduction is now limited to 90% of taxable income for regular income tax purposes and 80% for AMT purposes.

Significant changes to the sales and use tax regime include adjustments to the Business to Business exclusion. The business to business exclusion applicable to services rendered from one registered business to another registered business remains in effect, except for certain services that will be taxable, including, among others, service charges imposed by financial institutions on other businesses (commercial clients), collection services, repairs and maintenance services related to real and personal property, and computer programming services, including modifications to previously designed systems. The sales and use tax provisions were effective beginning on July 1, 2013.

On October 14, 2013, the Governor of Puerto Rico signed into law Act No. 117 (“Act 117”) providing additional changes and transitional provisions in connection with Act 40. In relation to the national gross receipts tax, Act 117 clarifies, among other things, that gross income subject to the special tax does not include the following:

(i) Dividends received from a 100% controlled domestic subsidiary. During the first nine months of 2014, no dividends subject to this exception were received by any of the Corporation’s entities.

(ii) Income attributable to a trade or business outside of Puerto Rico.

On July 1, 2014, the Puerto Rico Government approved Act No. 77 (“Act 77”), Act for Adjustments to Tax System, which amended the 2011 PR Code. Some of the main provisions that impact corporations follow:

(i) Long Term Capital Gain Tax Rate is increased from 15% to 20% and Long Term Capital Treatment was amended to apply only to assets held for a period of 1 year or more (previously 6 months or more) for transactions completed after June 30, 2014. As a result of this change, the deferred tax liability related to unrealized gains of available for sale securities was increased by \$0.3 million and other deferred tax assets related to capital losses were increased by \$0.1 million.

(ii) New Capital Loss carryover limitation, of up to 90% of Capital Gains and the carryover period of NOL’s attributable to capital losses incurred during taxable years commencing after December 31, 2013 was increased from 5 years to 7 years.

(iii) The credit for AMT paid in previous years will be limited to 25% of the excess of the regular income tax over the tentative minimum tax.

(iv) The national gross receipts tax rate for financial institutions was not affected by Act 77 and remains at 1% and financial institutions continue to claim 0.5% of their gross income as a credit against regular income tax or the AMT. However, tax credits purchased or generated by the institution are not allowed as a credit against the national gross receipts tax obligation.

None of these provisions of Act 77 had a material impact on the Corporation in 2014.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through an International Banking Entity (“IBE”) of the Bank and through the Bank’s subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation. The IBE and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at normal rates to the extent that the IBE’s net income exceeds 20% of the bank’s total net taxable income.

For the quarter and nine-month period ended September 30, 2014, the Corporation recorded an income tax expense of \$0.1 million and \$0.7 million, respectively, compared to an income tax expense of \$3.7 million and \$4.3 million, respectively, for the same periods in 2013. The variance in the third quarter of 2014 compared to the same period in 2013 was mainly driven by an increase of \$3.1 million in 2013 to the reserve for uncertain tax positions and, to a lesser extent, lower taxable income from profitable subsidiaries. The decrease in the income tax expense for the nine-month period comparison mainly reflects a variance of \$4.9 million related to adjustments to the reserve for uncertain tax positions, partially offset by the \$0.3 million reduction in the national gross receipts tax credit and the impact in 2013 of a net benefit of approximately \$0.5 million related to the increase in the deferred tax asset of profitable subsidiaries due to changes in statutory tax rates.

The income tax in the interim financial statements is calculated based on the income of the individual subsidiaries and the currently valid tax rates as a best possible estimate. As of September 30, 2014, the deferred tax asset, net of a valuation allowance of \$505.2 million, amounted to \$9.9 million compared to \$7.6 million as of December 31, 2013. The decrease in the valuation allowance to \$505.2 million, as of September 2014, from \$522.7 million as of December 31, 2013 was mainly due to the reversal of temporary differences primarily attributable to the reduction in the allowance for loan and lease losses during the first nine months of 2014.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on an assessment of the amount of the deferred tax asset that is “more likely than not” to be realized. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized.

In making such assessment, significant weight is given to evidence that can be objectively verified, including both positive and negative evidence. Consideration must be given to all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of the reversal of temporary differences and carry forwards, taxable income in carry back years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the maintenance of the valuation allowance was that the Corporation’s banking subsidiary, FirstBank Puerto Rico, was in a three-year historical cumulative loss position as of September 30, 2014, mainly due to significant charges to the provision for loan and lease losses in prior years as a result of the economic downturn and the bulk sales of assets completed in 2013. As of September 30, 2014, the Corporation had a gross deferred tax asset of \$525.4 million, including \$373.6 million associated with NOLs. The Bank incurred all of the NOLs on or after 2009. As mentioned before, the Corporation maintained a valuation allowance of \$505.2 million as of September 30, 2014 against the deferred tax asset. As of September 30, 2014, management concluded that \$9.9 million of the deferred tax asset will be realized as it relates to profitable subsidiaries and to amounts that can be realized through future reversals of existing taxable temporary differences. To the extent the realization of a portion, or all, of the tax asset becomes “more likely than not” based on changes in circumstances (such as, improved earnings, changes in tax laws or other relevant changes), a

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements 127

reversal of that portion of the deferred tax asset valuation allowance will then be recorded.

The authoritative accounting guidance prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under this guidance, income tax benefits are recognized and measured based upon a two-step analysis: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized under this analysis and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit (“UTB”).



The following table reconciles the balance of UTBs:					
		Nine-Month Period Ended September 30, 2014		Nine-Month Period Ended September 30, 2013	
(In thousands)					
Balance beginning of the year	\$	4,310	\$	2,374	
(Decrease) increase related to positions taken during prior years		(1,763)		3,102	
Decrease related to settlement with taxing authorities		(2,547)		-	
Balance at end of period	\$	-	\$	5,476	

As of September 30, 2014, the Corporation did not have UTBs recorded on its books. The years 2007 through 2009 were examined by IRS and disputed issues were taken to administrative appeals during 2011. Based on feasible settlement with the IRS Appeals office in June 2014, the Corporation released a portion of its reserve for uncertain tax positions, resulting in a tax benefit of approximately \$1.8 million. During the month of July 2014, the Corporation reached an agreement with the IRS Appeals office. Accordingly, the remaining UTB's recorded on the books in the amount of \$2.5 million was paid to settle the resulting tax liability. Such settlement did not have an impact on the effective tax rate.

The Corporation's liability for income taxes includes the estimate of interest not yet paid related to the settlement reached with the IRS to close the tax years 2007 through 2009 that were the subject of the IRS examination. The Corporation classifies all interest and penalties, if any, related to tax uncertainties as income tax expense. As of September 30, 2014, the Corporation's accrued interest that relates to the IRS examination amounted to \$1.4 million and there was no need to accrue for the payment of penalties. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the 2011 PR Code is 4 years; the statute of limitations for Virgin Islands and U.S. income tax purposes are each three years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation's liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Virgin Islands and U.S. income tax purposes, all tax years subsequent to 2010 remain open to examination. For Puerto Rico purposes, all tax years subsequent to 2009 remain open to examination. Tax year 2010 is currently under examination by the Puerto Rico Department of Treasury.

**NOTE 19 – FAIR VALUE***Fair Value Measurement*

The FASB authoritative guidance for fair value measurement defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy for classifying financial instruments. The hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Three levels of inputs may be used to measure fair value:

<b>Level 1</b>	Valuations of Level 1 assets and liabilities are obtained from readily available pricing sources for market transactions involving identical assets or liabilities. Level 1 assets and liabilities include equity securities that trade in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities and corporate debt securities that are traded by dealers or brokers in active markets.
<b>Level 2</b>	Valuations of Level 2 assets and liabilities are based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on the value of identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments, and (iii) derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
<b>Level 3</b>	Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models for which the determination of fair value required significant management judgments estimation.

For 2014, there were no transfers into or out of the Level 1, Level 2 or Level 3 measurement classification of the fair value hierarchy.

***Financial Instruments Recorded at Fair Value on a Recurring Basis***

*Investment securities available for sale*

The fair value of investment securities was the market value based on quoted market prices (as is the case with equity securities, U.S. Treasury notes, and non-callable U.S. Agency debt securities), when available (Level 1), or market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters, including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference data including market research operations (Level 2). Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument, as is the case with certain private label mortgage-backed securities held by the Corporation (Level 3).

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States; the interest rate on the securities is variable, tied to three-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread based on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e. loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, and others) in combination with prepayment forecasts obtained from a commercially available prepayment model (ADCO). The variable cash flow of the security is modeled using the 3-month LIBOR forward curve. Loss assumptions were driven by the combination of default and loss severity estimates, taking into account loan credit characteristics (loan-to-value, state, origination date, property type, occupancy loan purpose, documentation type, debt-to-income ratio, and other) to provide an estimate of default and loss severity.

Refer to the table below for further information regarding qualitative information for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

*Derivative instruments*

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements

The fair value of most of the Corporation's derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties when appropriate, except when collateral is pledged. That is, on interest rate swaps, the credit risk of both counterparties is included in the valuation; and, on options and caps, only the seller's credit risk is considered. The derivative instruments, namely swaps and caps, were valued based on a discounted cash flow approach using the related LIBOR and swap rate for each cash flow. Derivatives include interest rate swaps used for protection against rising interest rates. For these interest rate swaps, a credit component was not considered in the valuation since the Corporation has fully collateralized with investment securities any mark-to-market loss with the counterparty and, if there were market gains, the counterparty had to deliver additional collateral to the Corporation.

Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments for the quarter and nine-month period ended September 30, 2014 was immaterial.

The information about the estimated fair value of financial instruments required by GAAP is presented hereunder. The fair value amounts presented do not necessarily represent management's estimate of the underlying value of the Corporation.

Assets and liabilities measured at fair value on a recurring basis, are summarized below:									
As of September 30, 2014					As of December 31, 2013				
Fair Value Measurements Using					Fair Value Measurements Using				
(In thousands)	Level 1	Level 2	Level 3	Assets/Liabilities at Fair Value	Level 1	Level 2	Level 3	Assets/Liabilities at Fair Value	
Assets:									
Securities available for sale :									
Equity securities	\$ 14	\$ -	\$ -	\$ 14	\$ 33	\$ -	\$ -	\$ 33	
U.S. Treasury Securities	7,498	-	-	7,498	7,499	-	-	7,499	
Noncallable U.S. agency debt	-	220,856	-	220,856	-	200,903	-	200,903	
Callable U.S. agency debt and MBS	-	1,666,264	-	1,666,264	-	1,677,651	-	1,677,651	
Puerto Rico government obligations	-	43,623	2,766	46,389	-	48,904	2,426	51,330	
Private label MBS	-	-	36,116	36,116	-	-	40,866	40,866	
Derivatives, included in assets:									
Interest rate swap agreements	-	67	-	67	-	162	-	162	
Purchased interest rate cap agreements	-	18	-	18	-	58	-	58	
Forward contracts	-	17	-	17	-	174	-	174	
Liabilities:									
Derivatives,									

included in liabilities:													
Interest rate swap agreements	-	2,877	-	2,877	-	3,965	-	3,965					
Written interest rate cap agreement	-	18	-	18	-	58	-	58					
Forward contracts	-	16	-	16	-	-	-	-					

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters and nine-month period ended September 30, 2014 and 2013:

		Quarter ended September 30,			
		2014		2013	
Level 3 Instruments Only		Securities		Securities	
(In thousands)		Available For Sale <sup>(1)</sup>		Available For Sale <sup>(1)</sup>	
Beginning balance		\$	40,918	\$	48,660
Total gains or (losses) (realized/unrealized):					
Included in earnings			(245)		-
Included in other comprehensive income			333		903
Principal repayments and amortization			(2,124)		(4,643)
Ending balance		\$	38,882	\$	44,920
(1)	Amounts mostly related to private label mortgage-backed securities.				

		Nine-Month Period Ended September 30,			
		2014		2013	
Level 3 Instruments Only		Securities		Securities	
(In thousands)		Available For Sale <sup>(1)</sup>		Available For Sale <sup>(1)</sup>	
Beginning balance		\$	43,292	\$	54,617
Total gains or (losses) (realized/unrealized):					
Included in earnings			(245)		(117)
Included in other comprehensive income			2,026		1,763
Purchases			5,123		-
Sales			(4,855)		-
Principal repayments and amortization			(6,459)		(11,343)
Ending balance		\$	38,882	\$	44,920

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements 134

(1)	Amounts mostly related to private label mortgage-backed securities.					

The table below presents qualitative information for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at September 30, 2014:							
September 30, 2014							
(In thousands)	Fair Value		Valuation Technique	Unobservable Input	Range		
<b>Investment securities available-for-sale:</b>							
Private label MBS	\$	36,116	Discounted cash flow	Discount rate	14.5%		
				Prepayment rate	19.21% -100% (Weighted Average 31%)		
				Projected cumulative loss rate	0.94% -80.00% (Weighted Average 7.6%)		
Puerto Rico Government Obligations		2,766	Discounted cash flow	Prepayment speed	5.57%		

### *Information about Sensitivity to Changes in Significant Unobservable Inputs*

Private label MBS: The significant unobservable inputs in the valuation include probability of default, the loss severity assumption and prepayment rates. Shifts in those inputs would result in different fair value measurements. Increases in the probability of default, loss severity assumptions, and prepayment rates in isolation would generally result in an adverse effect on the fair value of the instruments. Meaningful and possible shifts of each input were modeled to assess the effect on the fair value estimation.

Puerto Rico Government Obligations: The significant unobservable input used in the fair value measurement is the assumed prepayment rate. A significant increase (decrease) in the assumed rate would lead to a higher (lower) fair value estimate. Loss severity and probability of default are not included as significant unobservable variables because the obligations are guaranteed by the Puerto Rico Housing Finance Authority (“PRHFA”). The PRHFA credit risk is modeled by discounting the cash flows using a curve appropriate to the PRHFA credit rating.

The tables below summarize changes in unrealized gains and losses recorded in earnings for the quarters and nine-month periods ended September 30, 2014 and 2013 for Level 3 assets and liabilities that are still held at the end of each period:



		Changes in Unrealized Losses			Changes in Unrealized Losses
		Quarter ended September 30, 2014			Quarter ended September 30, 2013
Level 3 Instruments Only		Securities			Securities
(In thousands)		Available For Sale			Available For Sale
<b>Changes in unrealized losses relating to assets still held at reporting date:</b>					
Net impairment losses on available-for-sale investment securities (credit component)		\$	(245)		\$ -

			Changes in Unrealized Losses		Changes in Unrealized Losses
			Nine-Month Period Ended September 30, 2014		Nine-Month Period Ended September 30, 2013
Level 3 Instruments Only		Securities			Securities
(In thousands)		Available For Sale			Available For Sale
<b>Changes in unrealized losses relating to assets still held at reporting date:</b>					
Net impairment losses on available-for-sale investment securities (credit component)		\$	(245)	\$	(117)

Additionally, fair value is used on a nonrecurring basis to evaluate certain assets in accordance with GAAP. Adjustments to fair value usually result from the application of lower-of-cost or market accounting (e.g., loans held for sale carried at the lower-of-cost or fair value and repossessed assets) or write downs of individual assets (e.g., goodwill, loans).

As of September 30, 2014, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:												
Carrying value as of September 30, 2014										(Losses) Gain recorded for the Quarter Ended September 30, 2014		(Losses) Gain recorded for the Nine Month Period Ended September 30, 2014
Level 1			Level 2			Level 3						
(In thousands)												
Loans receivable <sup>(1)</sup>	\$	-	\$	-	\$	461,882	\$	(6,495)	\$	(30,376)		
OREO <sup>(2)</sup>		-		-		112,803		(2,287)		(10,544)		
Mortgage servicing rights <sup>(3)</sup>		-		-		22,503		(46)		(226)		
Loans Held For Sale <sup>(4)</sup>		-		-		54,641		-		-		
(1)	Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair value was derived from external appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.											
(2)	The fair value was derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates and net operating income of income producing properties) which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.											
(3)	Fair value adjustments to mortgage servicing rights were mainly due to assumptions associated with mortgage prepayment rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment rate 9.71%, Discount Rate 10.63%.											
(4)	The value of these loans was derived from external appraisals, adjusted for specific characteristics of the loans, and for loans with signed sale agreements, the value was determined based on the sales price on such agreements.											



As of September 30, 2013, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:

As of September 30, 2013, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:										
Carrying value as of September 30, 2013									(Losses) Gain recorded for the Quarter Ended September 30, 2013	(Losses) Gain recorded for the Nine-Month Period Ended September 30, 2013
Level 1			Level 2			Level 3				
(In thousands)										
Loans receivable <sup>(1)</sup>	\$	-	\$	-	\$	450,267	\$	(7,034)	\$	(24,431)
OREO <sup>(2)</sup>		-		-		133,284		(4,479)		(15,505)
Mortgage servicing rights <sup>(3)</sup>		-		-		21,885		32		589
Loans Held For Sale <sup>(4)</sup>		-		-		80,234		(397)		(10,073)
(1)	Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair value was derived from external appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.									
(2)	The fair value was derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates and net operating income of income producing properties) which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.									
(3)	Fair value adjustments to the mortgage servicing rights were mainly due to assumptions associated with mortgage prepayments rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment Rate 9.37%, Discount Rate 10.59%.									
(4)	The value of these loans was derived from external appraisals, adjusted for specific characteristics of the loans, and, for loans with signed sale agreements, the value was determined based on the sales price on such agreements.									

Qualitative information regarding the fair value measurements for Level 3 financial instruments are as follows:			
September 30, 2014			
	Method		Inputs
Loans	Income, Market, Comparable Sales, Discounted Cash Flows		External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors

OREO	Income, Market, Comparable Sales, Discounted Cash Flows		External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors
Mortgage servicing rights	Discounted Cash Flow		Weighted average prepayment rate 9.71%; weighted average discount rate 10.63%

The following is a description of the valuation methodologies used for instruments that are not measured and reported at fair value on a recurring basis or reported at fair value on a non-recurring basis. The estimated fair value was calculated using certain facts and assumptions, which vary depending on the specific financial instrument.

*Cash and due from banks and money market investments*

The carrying amounts of cash and due from banks and money market investments are reasonable estimates of their fair value. Money market investments include held-to-maturity securities, which have a contractual maturity of three months or less. The fair value of these securities is based on quoted market prices in active markets that incorporate the risk of nonperformance.

*Other equity securities*

Equity or other securities that do not have a readily available fair value are stated at their net realizable value, which management believes is a reasonable proxy for their fair value. This category is principally composed of stock that is owned by the Corporation to comply with FHLB regulatory requirements. The realizable value of the FHLB stock equals its cost as this stock can be freely redeemed at par.

*Loans receivable, including loans held for sale*

The fair value of loans held for investment and for mortgage loans held for sale was estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms and credit quality and with adjustments that the Corporation's management believes a market participant would consider in determining fair value. Loans were classified by type, such as commercial, residential mortgage, and automobile. These asset categories were further segmented into fixed- and adjustable-rate categories. Valuations are carried out based on categories and not on a loan-by-loan basis. The fair values of performing fixed-rate and adjustable-rate loans were calculated by discounting expected cash flows through the estimated maturity date. This fair value is not currently an indication of an exit price as that type of assumption could result in a different fair value estimate. The fair value of credit card loans was estimated using a discounted cash flow method and excludes any value related to a customer account relationship. Other loans with no stated maturity, like credit lines, were valued at book value. Prepayment assumptions were considered for non-residential loans. For residential mortgage loans, prepayment estimates were based on a prepayments model that combined both a historical calibration and current market prepayment expectations. Discount rates were based on the Treasury and LIBOR/Swap Yield Curves at the date of the analysis, and included appropriate adjustments for expected credit losses and liquidity. For impaired collateral dependent loans, the impairment was primarily measured based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observable transactions involving similar assets in similar locations. The market valuation of

the loans acquired from Doral in the second quarter of 2014 was derived from a model that utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. The cash flows were modeled using a static cash flow analysis discounted by yields observed in the secondary market and in combination with prepayment forecasts. Loss assumptions were driven by the combination of default and loss severity estimates, taking into account loan credit characteristics (loan-to-value, Puerto Rico market, loan type, delinquency status, loan terms, and other), with higher default rates applied to loans acquired with evidence of credit deterioration.

### *Deposits*

The estimated fair value of demand deposits and savings accounts, which are deposits with no defined maturities, equals the amount payable on demand at the reporting date. The fair values of retail fixed-rate time deposits, with stated maturities, are based on the present value of the future cash flows expected to be paid on the deposits. The cash flows were based on contractual maturities; no early repayments were assumed. Discount rates were based on the LIBOR yield curve.

The estimated fair value of total deposits excludes the fair value of core deposit intangibles, which represent the value of the customer relationship measured by the value of demand deposits and savings deposits that bear a low or zero rate of interest and do not fluctuate in response to changes in interest rates. The fair value of brokered CDs, which are included within deposits, is determined using discounted cash flow analyses over the full term of the CDs.

The fair value of the CDs is computed using the outstanding principal amount. The discount rates used were based on brokered CD market rates as of September 30, 2014. The fair value does not incorporate the risk of nonperformance, since interests in brokered CDs are generally sold by brokers in amounts of less than \$250,000 and, therefore, are insured by the FDIC.

#### *Securities sold under agreements to repurchase*

Some repurchase agreements reprice at least quarterly, and their outstanding balances are estimated to be their fair value. Where longer commitments are involved, fair value is estimated using exit price indications of the cost of unwinding the transactions as of the end of the reporting period. The brokers who are the counterparties provide these indications. Securities sold under agreements to repurchase are fully collateralized by investment securities.

#### *Advances from FHLB*

The fair value of advances from FHLB with fixed maturities is determined using discounted cash flow analyses over the full term of the borrowings, using indications of the fair value of similar transactions. The cash flows assume no early repayment of the borrowings. Discount rates are based on the LIBOR yield curve. Advances from FHLB are fully collateralized by mortgage loans and, to a lesser extent, investment securities.

#### *Other borrowings*

Other borrowings consist of junior subordinated debentures. Projected cash flows from the debentures were discounted using the Bloomberg BB Finance curve plus a credit spread. This credit spread was estimated using the difference in yield curves between Swap rates and a yield curve that considers the industry and credit rating of the Corporation as issuer of the note at a tenor comparable to the time to maturity of the debentures.





The following table presents the estimated fair value and carrying value of financial instruments as of September 30, 2014 and December 31, 2013:

	<b>Total Carrying Amount in Statement of Financial Condition September 30, 2014</b>		<b>Fair Value Estimate September 30, 2014</b>		<b>Level 1</b>		<b>Level 2</b>		<b>Level 3</b>					
<b>(In thousands)</b>														
<b>Assets:</b>														
Cash and due from banks and money														
market investments	\$	969,995	\$	969,995	\$	969,995	\$	-	\$	-				
Investment securities available for sale		1,977,137		1,977,137		7,512		1,930,743		38,882				
Other equity securities		25,752		25,752		-		25,752		-				
Loans held for sale		80,014		80,937		-		26,296		54,641				
Loans, held for investment		9,315,402												
Less: allowance for loan and lease losses		(225,434)												
Loans held for investment, net of allowance	\$	9,089,968		8,853,184		-		-		8,853,184				
Derivatives, included in assets		102		102		-		102		-				
<b>Liabilities:</b>														
Deposits		9,703,174		9,702,567		-		9,702,567		-				
Securities sold under agreements to repurchase		900,000		964,946		-		964,946		-				
Advances from FHLB		325,000		323,656		-		323,656		-				
Other borrowings		231,959		137,127		-		-		137,127				
Derivatives, included in		2,911		2,911		-		2,911		-				

liabilities														

	Total Carrying Amount in Statement of Financial Condition December 31, 2013		Fair Value Estimate December 31, 2013		Level 1		Level 2		Level 3	
(In thousands)										
<b>Assets:</b>										
Cash and due from banks and money										
market investments	\$	655,671	\$	655,671	\$	655,671	\$	-	\$	-
Investment securities available for sale		1,978,282		1,978,282		7,532		1,927,458		43,292
Other equity securities		28,691		28,691		-		28,691		-
Loans held for sale		75,969		76,684		-		21,883		54,801
Loans, held for investment		9,636,170								
Less: allowance for loan and lease losses		(285,858)								
Loans held for investment, net of allowance	\$	9,350,312		9,127,234		-		-		9,127,234
Derivatives, included in assets		394		394		-		394		-
<b>Liabilities:</b>										
Deposits		9,879,924		9,898,615		-		9,898,615		-
Securities sold under agreements to repurchase		900,000		976,151		-		976,151		-
Advances from FHLB		300,000		297,523		-		297,523		-
Other borrowings		231,959		106,772		-		-		106,772
Derivatives, included in liabilities		4,023		4,023		-		4,023		-



## NOTE 20 – SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows:

	Nine-Month Period Ended September 30,			
	2014		2013	
	(In thousands)			
Cash paid for:				
Interest on borrowings	\$	76,975	\$	93,373
Income tax		6,427		3,508
Non-cash investing and financing activities:				
Additions to other real estate owned		19,313		54,937
Additions to auto and other repossessed assets		69,409		52,146
Capitalization of servicing assets		3,144		6,467
Loan securitizations		144,569		300,241
Loans held for investment transferred to held for sale		-		181,620
Preferred stock exchanged for new common stock issued:				
Preferred stock exchanged (Series A through E)		26,022		-
New common stock issued		24,363		-

## NOTE 21 – SEGMENT INFORMATION

Based upon the Corporation's organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation's lines of business for its operations in Puerto Rico, the Corporation's principal market, and by geographic areas for its operations outside of Puerto Rico. As of September 30, 2014, the Corporation had six reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States Operations, and Virgin Islands Operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Others factors such as the Corporation's organizational chart, nature of the products, distribution channels, and the economic characteristics of the product were also considered in the determination of the reportable segments.

The Commercial and Corporate Banking segment consists of the Corporation's lending and other services for large customers represented by specialized and middle-market clients and the public sector. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. The Mortgage Banking segment consists of the origination, sale, and servicing of a variety of residential mortgage loans. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. In addition, the Mortgage Banking segment includes mortgage loans purchased from other local banks and mortgage bankers. The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investments segment is responsible for the Corporation's investment portfolio and treasury functions executed to manage and enhance liquidity. This segment lends funds to the Commercial and Corporate Banking, Mortgage Banking and Consumer (Retail) Banking segments to finance their lending activities and borrows from those segments and from the United States Operations segment. The Consumer (Retail) Banking and the United States Operations segments also lend funds to other segments. The interest rates charged or credited by Treasury and Investments, the Consumer (Retail) Banking and the United States Operations segments are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation's actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment. The United States Operations segment consists of all banking activities conducted by FirstBank in the United States mainland, including commercial and retail banking services. The Virgin Islands Operations segment consists of all banking activities conducted by the Corporation in the USVI and BVI, including commercial and retail banking services.

The accounting policies of the segments are the same as those referred to in Note 1- "Nature of Business and Summary of Significant Accounting Policies."

The Corporation evaluates the performance of the segments based on net interest income, the estimated provision for loan and lease losses, non-interest income and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses.

Supplemental cash flow information is as follows:



The following table presents information about the reportable segments:							
(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
<b>For the quarter ended September 30, 2014:</b>							
Interest income	\$ 30,038	\$ 52,725	\$ 39,737	\$ 12,335	\$ 11,541	\$ 10,286	\$ 156,662
Net (charge) credit for transfer of funds	(9,541)	4,162	(3,354)	5,601	3,132	-	-
Interest expense	-	(5,902)	-	(17,323)	(4,855)	(888)	(28,968)
Net interest income	20,497	50,985	36,383	613	9,818	9,398	127,694
(Provision) release for loan and lease losses	(5,261)	(18,634)	(8,900)	-	6,791	(995)	(26,999)
Non-interest income (loss)	3,643	9,409	1,104	(190)	621	1,587	16,174
Direct non-interest expenses	(9,896)	(31,670)	(10,265)	(1,481)	(6,015)	(11,118)	(70,445)
Segment income (loss)	\$ 8,983	\$ 10,090	\$ 18,322	\$ (1,058)	\$ 11,215	\$ (1,128)	\$ 46,424
Average earnings assets	\$ 2,189,861	\$ 2,021,207	\$ 3,398,113	\$ 2,676,556	\$ 958,790	\$ 672,392	\$ 11,916,919
(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
<b>For the quarter ended September</b>							

Supplemental cash flow information is as follows:



Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

<b>30, 2013:</b>									
Interest income	\$ 27,307	\$ 57,967	\$ 43,085	\$ 14,801	\$ 9,201	\$ 9,842	\$ 162,203		
Net (charge) credit for transfer of funds	(8,948)	771	(3,294)	9,223	2,248	-	-		
Interest expense	-	(6,933)	-	(18,330)	(5,088)	(947)	(31,298)		
Net interest income	18,359	51,805	39,791	5,694	6,361	8,895	130,905		
(Provision) release for loan and lease losses	(6,040)	(15,190)	(4,516)	-	2,473	1,078	(22,195)		
Non-interest income (loss)	4,812	9,261	1,133	(1,390)	281	1,871	15,968		
Direct non-interest expenses	(10,073)	(30,954)	(14,039)	(3,022)	(6,847)	(10,192)	(75,127)		
Segment income	\$ 7,058	\$ 14,922	\$ 22,369	\$ 1,282	\$ 2,268	\$ 1,652	\$ 49,551		
Average earnings assets	\$ 1,981,707	\$ 2,086,403	\$ 3,842,877	\$ 2,666,427	\$ 766,405	\$ 665,812	\$ 12,009,631		

	<b>Mortgage Banking</b>	<b>Consumer (Retail) Banking</b>	<b>Commercial and Corporate</b>	<b>Treasury and Investments</b>	<b>United States Operations</b>	<b>Virgin Islands Operations</b>	<b>Total</b>
<b>Nine-month period ended September 30, 2014:</b>							
Interest income	\$ 83,230	\$ 163,406	\$ 122,861	\$ 41,906	\$ 33,316	\$ 30,937	\$ 475,656
Net (charge) credit for transfer of funds	(26,823)	11,933	(9,402)	15,985	8,307	-	-
Interest expense	-	(18,580)	-	(50,867)	(14,507)	(2,781)	(86,735)
Net interest	56,407	156,759	113,459	7,024	27,116	28,156	388,921

Supplemental cash flow information is as follows:

income								
(Provision) release for loan and lease losses	(12,734)	(58,604)	(36,424)	-	23,231	(1,127)	(85,658)	
Non-interest income	9,446	30,044	4,021	207	1,773	5,244	50,735	
Direct non-interest expenses	(30,068)	(95,195)	(37,537)	(4,121)	(20,504)	(28,806)	(216,231)	
Segment income	\$ 23,051	\$ 33,004	\$ 43,519	\$ 3,110	\$ 31,616	\$ 3,467	\$ 137,767	
Average earnings assets	\$ 2,059,427	\$ 1,953,726	\$ 3,731,842	\$ 2,700,429	\$ 896,667	\$ 666,279	\$ 12,008,370	
	<b>Mortgage Banking</b>	<b>Consumer (Retail) Banking</b>	<b>Commercial and Corporate</b>	<b>Treasury and Investments</b>	<b>United States Operations</b>	<b>Virgin Islands Operations</b>	<b>Total</b>	
<b>Nine-month period ended September 30, 2013:</b>								
Interest income	\$ 82,996	\$ 174,210	\$ 128,890	\$ 38,845	\$ 26,905	\$ 31,252	\$ 483,098	
Net (charge) credit for transfer of funds	(28,850)	(948)	(11,034)	33,738	7,094	-	-	
Interest expense	-	(20,774)	-	(60,305)	(16,788)	(2,945)	(100,812)	
Net interest income	54,146	152,488	117,856	12,278	17,211	28,307	382,286	
(Provision) release for loan and lease losses	(83,572)	(37,513)	(96,848)	-	4,907	(7,756)	(220,782)	
Non-interest income (loss)	9,400	29,558	3,922	(67,123)	1,168	5,899	(17,176)	
Direct non-interest expenses	(38,291)	(90,820)	(45,620)	(6,977)	(21,101)	(34,686)	(237,495)	
Segment (loss)	\$ (58,317)	\$ 53,713	\$ (20,690)	\$ (61,822)	\$ 2,185	\$ (8,236)	\$ (93,167)	

Supplemental cash flow information is as follows:

income								
Average earnings assets	\$ 2,057,792	\$ 1,970,184	\$ 4,067,908	\$ 2,710,260	\$ 731,143	\$ 666,989	\$ 12,204,276	

The following table presents a reconciliation of the reportable segment financial information to the consolidated totals:												
Quarter Ended						Nine-Month Period Ended						
September 30,						September 30,						
2014			2013			2014			2013			
<b>Net income (loss):</b>												
Total income (loss) for segments and other		\$	46,424		\$	49,551		\$	137,767		\$	(93,167)
Other non-interest income (1)			-			(5,908)			(7,280)			(10,798)
Other operating expenses (2)			(23,159)			(24,027)			(68,303)			(70,992)
Income (loss) before income taxes			23,265			19,616			62,184			(174,957)
Income tax expense			(64)			(3,676)			(675)			(4,319)
Total consolidated net income (loss)		\$	23,201		\$	15,940		\$	61,509		\$	(179,276)
<b>Average assets:</b>												
Total average earning assets for segments		\$	11,916,919		\$	12,009,631		\$	12,008,370		\$	12,204,276
Other average earning assets (1)			-			18,382			2,216			19,983
Average non-earning assets			650,624			558,349			654,845			641,427
Total consolidated average assets		\$	12,567,543		\$	12,586,362		\$	12,665,431		\$	12,865,686
(1)	The activities related to the Bank's equity interest in CPG/GS are presented as an Other non-interest income (loss) and as Other average earning assets in the table above.											
(2)	Expenses pertaining to corporate administrative functions that support the operating segments but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.											

**NOTE 22 – REGULATORY MATTERS, COMMITMENTS AND CONTINGENCIES**

The Corporation is subject to various regulatory capital requirements imposed by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of the Corporation's assets and liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation's capital amounts and classification are also subject to qualitative judgment and adjustment by the regulators with respect to minimum capital requirements, components, risk weightings and other factors.

Capital standards established by regulations require the Corporation to maintain minimum amounts and ratios for Leverage (Tier 1 capital to average total assets) and ratios of Tier 1 Capital to Risk-Weighted Assets and Total Capital to Risk-Weighted Assets as defined in the regulations. The total amount of risk-weighted assets is computed by applying risk-weighting factors to the Corporation's assets and certain off-balance sheet items, which generally vary from 0% to 100% depending on the nature of the asset. As discussed below in this note, the regulatory capital requirements will begin to change on January 1, 2015.

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into a Consent Order (the "FDIC Order") with the FDIC and OCIF. The FDIC Order provides for various things, including (among other things) the following: (1) having and retaining qualified management; (2) increased participation in the affairs of FirstBank by its Board of Directors; (3) development and implementation by FirstBank of a capital plan to attain a leverage ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 10% and a total risk-based capital ratio of at least 12%; (4) adoption and implementation of strategic, liquidity and fund management and profit and budget plans and related projects within certain timetables set forth in the FDIC Order and on an ongoing basis; (5) adoption and implementation of plans for reducing FirstBank's positions in certain classified assets and delinquent and non-accrual loans within timeframes set forth in the FDIC Order; (6) refraining from lending to delinquent or classified borrowers already obligated to FirstBank on any extensions of credit so long as such credit remains uncollected, except where FirstBank's failure to extend further credit to a particular borrower would be detrimental to the best interests of FirstBank, and any such additional credit is approved by FirstBank's Board of Directors; (7) refraining from accepting, increasing, renewing or rolling over brokered CDs without the prior written approval of the FDIC; (8) establishment of a comprehensive policy and methodology for determining the allowance for loan and lease losses and the review and revision of FirstBank's loan policies, including the non-accrual policy; and (9) adoption and implementation of adequate and effective programs of independent loan review, appraisal compliance, and an effective policy for managing FirstBank's sensitivity to interest rate risk. The foregoing summary is not complete and is qualified in all respects by reference to the actual language of the FDIC Order. Although all of FirstBank's regulatory capital ratios exceeded the minimum capital ratios for "well capitalized" levels, as well as the minimum capital ratios required by the FDIC Order, as of September 30, 2014, FirstBank cannot be treated as a "well capitalized" institution under regulatory guidance because it is operating under the FDIC Order.

Effective June 3, 2010, First BanCorp. entered into the Written Agreement with the New York FED. The Written Agreement provides, among other things, that the holding company must serve as a source of strength to FirstBank, and that, except with the consent generally of the New York FED and the Federal Reserve Board, (1) the holding company may not pay dividends to stockholders or receive dividends from FirstBank, (2) the holding company and its nonbank subsidiaries may not make payments on trust-preferred securities or subordinated debt, and (3) the holding company cannot incur, increase, or guarantee debt or repurchase any capital securities. The Written Agreement also requires that the holding company submit a capital plan that reflects sufficient capital at First BanCorp. on a consolidated basis, which must be acceptable to the New York FED, and follow certain guidelines with respect to the appointment or change in responsibilities of senior officers. The foregoing summary is not complete and is qualified in all respects by reference to the actual language of the Written Agreement.

The Corporation submitted its capital plan setting forth how it plans to improve capital positions to comply with the FDIC Order and the Written Agreement over time.

In addition to the Capital Plan, the Corporation has submitted to its regulators a liquidity and brokered CD plan, including a contingency funding plan, a non-performing asset reduction plan, a budget and profit plan, a strategic plan, and a plan for the reduction of classified and special mention assets. As of September 30, 2014, the Corporation had completed all of the items included in the Capital Plan and is continuing to work on reducing non-performing loans. Further, the Corporation has reviewed and enhanced the Corporation's loan review program, various credit policies, the Corporation's treasury and investment policy, the Corporation's asset classification and allowance for loan and lease losses and non-accrual policies, the Corporation's charge-off policy and the Corporation's appraisal program. The Regulatory Agreements also require the submission to the regulators of quarterly progress reports.

The FDIC Order imposes no other restrictions on FirstBank's products or services offered to customers, nor does it or the Written Agreement impose any type of penalties or fines upon FirstBank or the Corporation. Concurrent with the FDIC Order, the FDIC has granted FirstBank temporary waivers to enable it to continue accessing the brokered CD market through March 31, 2015. FirstBank will request approvals for future periods, although no assurance can be given that future approvals will be given.

In July 2013, U.S. banking regulators approved a revised regulatory capital framework for U.S. banking organizations (the "Basel 3 rules") that is based on international regulatory capital requirements adopted by the Basel Committee on Banking Supervision over the past several years. The Basel 3 rules introduce new minimum capital ratios and capital conservation buffer requirements, change the composition of regulatory capital, require a number of new adjustments to and deductions from regulatory capital, and introduce a new "Standardized Approach" for the calculation of risk-weighted assets that will replace the risk-weighting requirements under the current U.S. regulatory capital rules. The new minimum regulatory capital requirements and the Standardized Approach for the calculation of risk-weighted assets will become effective for the Corporation and FirstBank on January 1, 2015. The capital conservation buffer requirements, and the regulatory capital adjustments and deductions under the Basel 3 rules will be phased-in over several years ending on December 31, 2018.

The Basel 3 rules introduce a new and separate ratio of Common Equity Tier 1 capital ("CET1") to risk-weighted assets. CET1, a component of total Tier 1 capital, generally consists of common stock and related surplus, retained earnings, accumulated other comprehensive income ("AOCI"), and qualifying minority interests. In addition, the Basel 3 rules also will require the Corporation to maintain an additional CET1 capital conservation buffer of 2.5%. Thus, when the Basel 3 rules are fully phased in as of January 1, 2019, the Corporation will be required to maintain: (i) a minimum CET1 to risk-weighted assets ratio of at least 4.5%, plus the 2.5% "capital conservation buffer," resulting in a required minimum CET1 ratio of at least 7% upon full implementation, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5% upon full implementation, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5% upon full implementation, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets. The phase-in of the capital conservation buffer will begin on January 1, 2016 with a first year requirement of 0.625% of additional CET1, which will be progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully-phased in 2.5% CET1 requirement on January 1, 2019.

In addition, the Basel 3 rules require a number of new deductions from and adjustments to CET1, including deductions from CET1 for mortgage servicing rights, and deferred tax assets dependent upon future taxable income. In the case of mortgage servicing assets and deferred tax assets, among others, these items would be required to be deducted to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under current regulatory capital requirements, the effect of AOCI is excluded for the purposes of calculating the required regulatory capital ratios. By comparison, under the Basel 3 rules, the effects of certain AOCI items are not excluded. Certain banking organizations, however, including the Corporation and FirstBank, will be allowed to make a one-time permanent election in early 2015 to continue to exclude AOCI items.



The Corporation and FirstBank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the securities portfolio.

In addition, the Basel 3 rules will require that certain non-qualifying capital instruments, including cumulative preferred stock and Trust Preferred Securities (“TRuPs”), be excluded from Tier 1 capital. In general, banking organizations such as the Corporation and the Bank, must begin to phase out TRuPs from Tier 1 capital by January 1, 2015. The Corporation will be allowed to include 25% of the \$225 million outstanding qualifying TRuPs as Tier 1 capital in 2015 and the TRuPs must be fully phased out from Tier 1 capital by January 1, 2016. However, the Corporation’s TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

The Basel 3 rules also revise the “prompt corrective action” (“PCA”) regulations that apply to depository institutions, including FirstBank, pursuant to Section 38 of the Federal Deposit Insurance Act by (i) introducing a separate CET1 ratio requirement for each PCA capital category (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each PCA capital category, with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that allows a bank with a composite supervisory rating of 1 to have a 3% leverage ratio and still be adequately capitalized and maintaining the minimum leverage ratio for well-capitalized status at 5%. The Basel 3 rules do not change the total risk-based capital requirement (10% for well-capitalized status) for any PCA capital category. The new PCA requirements become effective on January 1, 2015.

The Basel 3 rules separately impose a Standardized Approach for risk-weightings that expands the risk-weighting categories from the four major risk-weighting categories under the current regulatory capital rules (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets. In a number of cases, the Standardized Approach will result in higher risk weights for a variety of asset categories. Specific changes to the risk-weightings of assets under the current regulatory capital rules include, among other things: (i) applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans, (ii) assigning a 150% risk weight to exposures that are 90 days past due (other than qualifying residential mortgage exposures, which remain at an assigned risk-weighting of 100%), and (iii) establishing a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, in contrast to the 0% risk-weighting under the current rules.

The Corporation’s total capital, Tier I and leverage ratios as of September 30, 2014 were 18.57%, 17.30% and 12.34%, respectively. Meanwhile, the total capital, Tier I capital, and leverage ratios as of September 30, 2014 of the banking subsidiary, FirstBank Puerto Rico, were 18.21%, 16.95% and 12.10%, respectively.

The Corporation enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit and

Supplemental cash flow information is as follows:

commitments to sell mortgage loans at fair value. As of September 30, 2014, commitments to extend credit amounted to approximately \$1.1 billion, of which \$648.4 million relates to credit card loans. Commercial and Financial standby letters of credit amounted to approximately \$47.0 million. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with prospective borrowers.

As of September 30, 2014, First BanCorp and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes that the final disposition of these matters, to the extent not previously provided for, will not have a material adverse effect, individually or in the aggregate, on the Corporation's financial position, results of operations or cash flows.

**NOTE 23 – FIRST BANCORP. (HOLDING COMPANY ONLY) FINANCIAL INFORMATION**

The following condensed financial information presents the financial position of the Holding Company only as of September 30, 2014 and December 31, 2013 and the results of its operations for the quarters and nine-month periods ended September 30, 2014 and 2013.

<b>Statements of Financial Condition</b>					
	<b>As of September 30,</b>			<b>As of</b>	
	<b>2014</b>			<b>December 31,</b>	
	<b>2013</b>				
	<b>(In thousands)</b>				
<b>Assets</b>					
Cash and due from banks	\$	29,990		\$	31,957
Money market investments		6,111			6,111
Investment securities available for sale, at market:					
Equity investments		14			33
Other investment securities		285			285
Loans held for investment, net		333			356
Investment in First Bank Puerto Rico, at equity		1,516,603			1,403,612
Investment in First Bank Insurance Agency, at equity		11,537			9,834
Investment in FBP Statutory Trust I		3,093			3,093
Investment in FBP Statutory Trust II		3,866			3,866
Other assets		4,683			4,101
Total assets	\$	1,576,515		\$	1,463,248
<b>Liabilities and Stockholders' Equity</b>					
<b>Liabilities:</b>					
Other borrowings	\$	231,959		\$	231,959
Accounts payable and other liabilities		20,399			15,431
Total liabilities		252,358			247,390
Stockholders' equity		1,324,157			1,215,858
Total liabilities and stockholders' equity	\$	1,576,515		\$	1,463,248

	<b>Quarter Ended</b>			<b>Nine-Month Period Ended</b>		
	<b>September 30,</b>			<b>September 30,</b>		

Supplemental cash flow information is as follows:

	2014		2013		2014		2013	
	(In thousands)				(In thousands)			
<b>Income:</b>								
Interest income on money market investments	\$	5	\$	5	\$	15	\$	16
Other income		55		54		163		178
		60		59		178		194
<b>Expense:</b>								
Notes payable and other borrowings		1,818		1,790		5,365		5,299
Other operating expenses		693		2,484		1,967		5,093
		2,511		4,274		7,332		10,392
Impairment on equity securities		-		-		-		(42)
<b>Loss before income taxes and equity</b>								
<b>in undistributed earnings (losses) of subsidiaries</b>		(2,451)		(4,215)		(7,154)		(10,240)
<b>Income tax benefit (provision)</b>		1		-		(3)		-
<b>Equity in undistributed earnings (losses) of subsidiaries</b>		25,651		20,155		68,666		(169,036)
<b>Net income (loss)</b>	\$	23,201	\$	15,940	\$	61,509	\$	(179,276)
<b>Other Comprehensive (loss) income, net of tax</b>		(5,916)		(18,343)		44,413		(86,917)
<b>Comprehensive income (loss)</b>	\$	17,285	\$	(2,403)	\$	105,922	\$	(266,193)

## NOTE 24 – SUBSEQUENT EVENTS

On October 2, 2014, the Corporation's banking subsidiary, FirstBank Puerto Rico, entered into a Mortgage Loan Purchase and Sale and Interim Servicing Agreement (the "Purchase Agreement") with Doral Bank, a wholly-owned subsidiary of Doral Financial Corporation. Pursuant to the Purchase Agreement, FirstBank purchased on October 3, 2014 (the "Closing Date") all rights, title and interests in certain performing residential mortgage loans (the "Mortgage Loans") with approximately \$192.6 million in outstanding unpaid principal balance.

As consideration for the purchase of the Mortgage Loans, FirstBank paid approximately \$192.7 million in cash (the "Purchase Price"), less a holdback of \$1.3 million which was deposited into escrow to cover certain representations and warranties made by Doral Bank with respect to the Mortgage Loans. Under the terms of the Purchase Agreement, FirstBank is entitled to a period of 90 days after the Closing Date for postclosing analysis of the Mortgage Loans, during which period FirstBank may provide notice to Doral Bank of any Mortgage Loan that does not conform to Doral Bank's representations and warranties under the Purchase Agreement (a "Defective Mortgage Loan"). Doral Bank may, in its sole discretion, elect to (i) cure the Defective Mortgage Loan, (ii) substitute the Defective Mortgage Loan with a mortgage in an amount equal to or greater than the unpaid principal balance and with a similar maturity date, or (iii) repurchase the Defective Mortgage Loan. Doral Bank's obligation to substitute or repurchase Defective Mortgage Loans in connection with the Purchase Agreement is limited to an amount not greater than \$8 million.

The Corporation incurred \$0.7 million in professional service fees during the third quarter of 2014 specifically related to this transaction.

The Mortgage Loans are being sold to FirstBank on a servicing-released basis. Doral Bank will continue to service the Mortgage Loans for an interim period.

The Corporation has performed an evaluation of all other events subsequent to September 30, 2014; management has determined that there are no other events occurring in this period that require disclosure in or adjustment to the accompanying financial statements.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)**

<b>SELECTED FINANCIAL DATA</b>										
		<b>Quarter ended</b>				<b>Nine-Month Period Ended</b>				
<b>(In thousands, except for per share and financial ratios)</b>		<b>September 30,</b>				<b>September 30,</b>				
		<b>2014</b>		<b>2013</b>		<b>2014</b>		<b>2013</b>		
<b>Condensed Income Statements:</b>										
Total interest income	\$	156,662		\$	162,203	\$	475,656		\$	483,098
Total interest expense		28,968			31,298		86,735			100,812
Net interest income		127,694			130,905		388,921			382,286
Provision for loan and lease losses		26,999			22,195		85,658			220,782
Non-interest income (loss)		16,174			10,060		43,455			(27,974)
Non-interest expenses		93,604			99,154		284,534			308,487
Income (loss) before income taxes		23,265			19,616		62,184			(174,957)
Income tax expense		(64)			(3,676)		(675)			(4,319)
Net income (loss)		23,201			15,940		61,509			(179,276)
Net income (loss) attributable to common stockholders		23,201			15,940		63,168			(179,276)
<b>Per Common Share Results:</b>										
Net earnings (loss) per share basic	\$	0.11		\$	0.08	\$	0.30		\$	(0.87)
Net earnings (loss) per share diluted	\$	0.11		\$	0.08	\$	0.30		\$	(0.87)
Cash dividends declared	\$	-		\$	-	\$	-		\$	-
Average shares outstanding		210,466			205,579		208,151			205,512
Average shares outstanding diluted		212,359			207,316		209,811			205,512
Book value per common share	\$	6.05		\$	5.59	\$	6.05		\$	5.59
Tangible book value per common share (1)	\$	5.81		\$	5.32	\$	5.81		\$	5.32
<b>Selected Financial Ratios (In Percent):</b>										
<b>Profitability:</b>										
Return on Average Assets		0.73			0.50		0.65			(1.86)
Interest Rate Spread (2)		4.07			4.15		4.17			3.94
Net Interest Margin (2)		4.25			4.34		4.35			4.15

Supplemental cash flow information is as follows:

## Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

	Return on Average Total Equity		7.01		5.19		6.43		(17.65)
	Return on Average Common Equity		7.21		5.47		6.69		(18.51)
	Average Total Equity to Average Total Assets		10.44		9.68		10.10		10.56
	Tangible common equity ratio (1)		9.82		8.65		9.82		8.65
	Dividend payout ratio		-		-		-		-
	Efficiency ratio (3)		65.06		70.34		65.81		87.07
<b>Asset Quality:</b>									
	Allowance for loan and lease losses to total loans held for investment		2.42		3.04		2.42		3.04
	Net charge-offs (annualized) to average loans (4) (5) (6)		1.80		1.41		2.04		4.97
	Provision for loan and lease losses to net charge-offs (7) (8)		63.17		65.54		58.64		60.19
	Non-performing assets to total assets (6)		5.89		5.68		5.89		5.68
	Non-performing loans held for investment to total loans held for investment (8)		6.01		5.24		6.01		5.24
	Allowance to total non-performing loans held for investment		40.29		58.06		40.29		58.06
	Allowance to total non-performing loans held for investment								
	excluding residential real estate loans		60.20		81.20		60.20		81.20
<b>Other Information:</b>									
	Common Stock Price: End of period	\$	4.75	\$	5.68	\$	4.75	\$	5.68
			<b>As of September 30, 2014</b>		<b>As of December 31, 2013</b>				
<b>Balance Sheet Data:</b>									
	Loans, including loans held for sale	\$	9,395,416	\$	9,712,139				
	Allowance for loan and lease losses		225,434		285,858				
	Money market and investment securities		2,019,846		2,208,342				
	Intangible assets		51,143		54,866				

Supplemental cash flow information is as follows:

	Deferred tax asset, net		9,853			7,644					
	Total assets		12,643,280			12,656,925					
	Deposits		9,703,174			9,879,924					
	Borrowings		1,456,959			1,431,959					
	Total preferred equity		36,104			63,047					
	Total common equity		1,322,376			1,231,547					
	Accumulated other comprehensive loss, net of tax		(34,323)			(78,736)					
	Total equity		1,324,157			1,215,858					

(1)	Non-GAAP measure. Refer to "Capital" discussion below for additional information about the components and a reconciliation of these measures.
(2)	On a tax-equivalent basis and excluding the changes in fair value of derivative instruments (see "Net Interest Income" discussion below for a reconciliation of this non-GAAP measure).
(3)	Non-interest expense to the sum of net interest income and non-interest income. The denominator includes non-recurring income and changes in the fair value of derivative instruments.
(4)	The net charge-offs to average loans ratio, excluding the impact associated with the acquisition of mortgage loans from Doral Financial Corporation, was 1.94% for the nine-month period ended September 30, 2014.
(5)	The net charge-offs to average loans ratio, excluding the impact associated with the bulk sales of assets and the transfer of loans to held for sale in 2013, was 1.87% for the nine-month period ended September 30, 2013.
(6)	Loans used in the denominator in calculating net charge-offs, non-performing loans and non-performing asset rates include purchased credit-impaired loans. However, the Corporation separately tracks and reports purchased credit impaired loans and excludes these from non-performing loan and non-performing asset statistics.
(7)	The provision for loan and lease losses to net charge-offs ratio, excluding the impact associated with the acquisition of mortgage loans from Doral Financial Corporation, was 60.52% for the nine-month period ended September 30, 2014.
(8)	The provision for loan and lease losses to net charge-offs ratio, excluding the impact associated with the bulk sales of assets and the transfer of loans to held for sale, was 66.07% for the nine-month period ended September 30, 2013.



The following Management's Discussion and Analysis of Financial Condition and Results of Operations relates to the accompanying consolidated unaudited financial statements of First BanCorp. (the "Corporation" or "First BanCorp.") and should be read in conjunction with such financial statements and the notes thereto.

## **EXECUTIVE SUMMARY**

First BanCorp. is a diversified financial holding company headquartered in San Juan, Puerto Rico offering a full range of financial products to consumers and commercial customers through various subsidiaries. First BanCorp. is the holding company of FirstBank Puerto Rico ("FirstBank" or the "Bank") and FirstBank Insurance Agency. Through its wholly-owned subsidiaries, the Corporation operates offices in Puerto Rico, the United States Virgin Islands and British Virgin Islands, and the State of Florida (USA), concentrating in commercial banking, residential mortgage loan originations, finance leases, credit cards, personal loans, small loans, auto loans, insurance agency and broker-dealer activities.

As described in Note 22 to the consolidated unaudited financial statements, Regulatory Matters, Commitment and Contingencies, FirstBank is operating under a Consent Order (the "FDIC Order") with the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico and First BanCorp. is operating under a Written Agreement (the "Written Agreement" and collectively with the FDIC Order, (the "Regulatory Agreements") with the Federal Reserve Bank of New York (the "New York FED" or "Federal Reserve").

## **OVERVIEW OF RESULTS OF OPERATIONS**

First BanCorp.'s results of operations generally depend primarily upon its net interest income, which is the difference between the interest income earned on its interest-earning assets, including investment securities and loans, and the interest expense incurred on its interest-bearing liabilities, including deposits and borrowings. Net interest income is affected by various factors, including: the interest rate scenario; the volumes, mix and composition of interest-earning assets and interest-bearing liabilities; and the re-pricing characteristics of these assets and liabilities. The Corporation's results of operations also depend on the provision for loan and lease losses, which has significantly affected the results of operations since 2009, non-interest expenses (such as personnel, occupancy, deposit insurance premium and other costs), non-interest income (mainly service charges and fees on deposits, insurance income and revenues from broker-dealer operations), gains (losses) on sales of investments, gains (losses) on mortgage banking activities, and income taxes.

Net income was \$23.2 million, or \$0.11 per diluted common share, for the quarter ended September 30, 2014, compared to \$15.9 million, or \$0.08 per diluted common share, for the same period in 2013.

Supplemental cash flow information is as follows:

The key drivers of the Corporation's financial results for the quarter ended September 30, 2014, compared to the same period in 2013, include the following:

- Net interest income decreased \$3.2 million to \$127.7 million for the quarter ended September 30, 2014 compared to the same period in 2013. The decrease was primarily due to a decline in the average yield of consumer loans (including finance leases) to 10.71%, from 11.71% in the third quarter of 2013. The decline in the average yield reflects both the impact of lower rates on new loan originations given the current level of interest rates and the fact that the remaining discount of the credit card portfolio acquired in 2012 was fully accreted into income during the first half of 2014. Other factors that affected the net interest income of the third quarter of 2014, compared to the third quarter of 2013, are the gradual reinvestment of mortgage-backed securities ("MBS") prepayments in lower-yielding investments given the low interest rate environment or the deposit of such prepayments in cash balances maintained at the Federal Reserve Bank and the overall decrease in the average volume of interest-earning assets.

The net interest margin, excluding fair value adjustments, decreased 7 basis points to 4.12% for the third quarter of 2014 compared to the same period in 2013 mainly driven by the aforementioned items, partially offset by a decrease in the average cost of funding. For a definition and reconciliation of this non-GAAP measure, refer to “Net Interest Income” discussion below.

- The provision for loan and lease losses of \$27.0 million for the third quarter of 2014, increased by \$4.8 million compared to the same period in 2013. The increase was primarily reflected in the Puerto Rico region driven by higher net charge-offs of commercial and industrial (“C&I”) loans, the increase in the general reserve for certain commercial credits that migrated to a different loan classification, and a higher general reserve for auto and small personal loans due to higher net charge-off levels and adjustments to account for general economic conditions. These variances were partially offset by higher recoveries of amounts previously charged-off, primarily related to the commercial mortgage and construction loan portfolios in Florida.

Net charge-offs totaled \$42.7 million for the third quarter of 2014, or 1.80% of average loans on an annualized basis, compared to \$33.9 million, or 1.41% of average loans for the same period in 2013. The increase was driven by approximately \$16.0 million of charge-offs recorded in the third quarter of 2014 related to two collateral dependent C&I relationships in Puerto Rico. Refer to the discussions under “Provision for loan and lease losses” and “Risk Management” below for an analysis of the allowance for loan and lease losses and non-performing assets and related ratios.

- The Corporation recorded non-interest income of \$16.2 million for the quarter ended September 30, 2014, compared to \$10.1 million for the same period in 2013. The increase mainly reflects the impact of the \$5.9 million loss recorded in the third quarter of 2013 related to the Bank’s investment in CPG/GS. In addition, there was an increase of \$0.3 million in revenues from mortgage banking activities driven by a decrease in mark-to-market losses on to-be-announced (“TBA”) MBS forward contracts used to hedge the securitization pipeline, partially offset by a decreased volume of loan sales to government-sponsored entities. Refer to the “Non-Interest Income” discussion below for additional information.

- Non-interest expenses decreased by \$5.6 million to \$93.6 million for the third quarter of 2014 compared to the same period in 2013. The decrease was mainly due to: (i) a \$2.7 million decrease in losses on other real estate owned (“OREO”) operations primarily due to lower write-downs to the value of OREO properties, (ii) a \$2.1 million decrease in the FDIC deposit insurance premium expense reflecting, among other things, improvements in liquidity, reductions in high-risk commercial loan balances, a strengthened capital position and improved trends in earnings, and (iii) a \$1.7 million decrease in expenses associated with the secondary offering of the Corporation’s common stock that occurred in the third quarter of 2013.

- For the third quarter of 2014, the Corporation recorded an income tax expense of \$0.1 million, compared to \$3.7 million for the same period in 2013. The decrease mainly reflects the impact in the third quarter of 2013 of an

Supplemental cash flow information is as follows:

increase of \$3.1 million to the reserve for uncertain tax positions and, to a lesser extent, lower taxable income from profitable subsidiaries. Refer to the “Income Taxes” discussion below for additional information.

- As of September 30, 2014, total assets were \$12.6 billion, a decrease of \$13.6 million from December 31, 2013. The decrease was mainly related to a \$256.3 million decline in total loans, net of allowance, mainly reflecting large commercial and construction loans paid off, a decrease of \$101.2 million in the outstanding balances of credit facilities granted to government entities, primarily in Puerto Rico, and a \$47.4 million decrease in the OREO inventory balance driven by sales and valuation adjustments. These decreases were partially offset by higher cash balances. Refer to the “Financial Condition and Operating Data” discussion below for additional information.

- As of September 30, 2014, total liabilities were \$11.3 billion, a decrease of \$121.9 million, from December 31, 2013. The decrease was mainly related to a \$237.2 million decrease in government deposits, mainly related to withdrawals by certain public corporations and government agencies in Puerto Rico during the second quarter of 2014, and a \$78.2 million decrease in brokered CDs. These variances were partially offset by a \$138.6 million increase in non-brokered deposits, excluding government deposits, mainly due to increases in savings and retail CDs, and a \$25.0 million increase related to a FHLB advance entered into in the third quarter of 2014. Refer to the “Risk Management – Liquidity and Capital Adequacy” discussion below for additional information about the Corporation’s funding sources.

- As of September 30, 2014, the Corporation’s stockholders’ equity was \$1.3 billion, an increase of \$108.3 million from December 31, 2013. The increase was mainly driven by the net income of \$61.5 million for the first nine months of 2014 and a \$44.4 million increase in other comprehensive income mainly attributable to an increase in the fair value of U.S. agency MBS and debt securities.

The Corporation’s Total Capital, Tier 1 Capital, and Leverage ratios increased to 18.57%, 17.30% and 12.34%, respectively, from 17.06%, 15.78% and 11.71%, respectively, as of December 31, 2013. Meanwhile, FirstBank’s Total Capital, Tier 1 Capital and Leverage ratios as of September 30, 2014 were 18.21%, 16.95% and 12.10%, respectively, compared to 16.67%, 15.40% and 11.44%, respectively, as of December 31, 2013. In addition, the Corporation’s tangible common equity ratio increased to 9.82% as of September 30, 2014, from 8.71% as of December 31, 2013, and the Tier 1 common equity to risk weighted-assets ratio increased to 14.39% as of September 30, 2014 from 12.72% as of December 31, 2013. Refer to the “Risk Management – Capital” section below for additional information including further information about these non-GAAP financial measures and recent regulatory capital changes. Although all the regulatory capital ratios exceeded the established “well capitalized” levels, as well as the minimum capital ratios required by the FDIC Order, as of September 30, 2014, FirstBank cannot be treated as a “well-capitalized” institution since it is still subject to the FDIC Order.

- Total loan production, including purchases, refinancings, renewals and draws from existing revolving and non-revolving commitments, was \$821.2 million for the quarter ended September 30, 2014, excluding the utilization activity of the outstanding credit cards portfolio, compared to \$836.6 million for the same period in 2013. The decrease in loan production was mainly related to consumer loans in Puerto Rico and lower volumes related to facilities of government entities in Puerto Rico and the Virgin Islands.

- Total non-performing loans, including non-performing loans held for sale, as of September 30, 2014, were \$614.2 million, an increase of \$63.8 million, or 12%, from December 31, 2013. This increase primarily reflects the inflow to non-performing of three large commercial relationships totaling \$83.8 million. In addition, the non-performing residential mortgage loan portfolio increased by \$23.6 million. These increases were partially offset by a \$28.8 million decrease in non-performing construction loans, mainly driven by charge-offs and the restoration to accrual status of a \$10.7 million loan that is current in payments and deemed collectible.

- Total non-performing assets were \$744.4 million as of September 30, 2014, an increase of \$19.0 million from December 31, 2013. The increase was driven by the aforementioned inflow of three large commercial relationships totaling \$83.8 million, partially offset by a \$47.4 million decrease in OREO, driven by sales and valuation adjustments. Refer to the “Risk Management - Non-accruing and Non-performing Assets” section below for additional information.
  
- Adversely classified commercial and construction loans held for investment decreased by \$51.6 million to \$571.4 million, or 8%, from December 31, 2013.

## **Critical Accounting Policies and Practices**

The accounting principles of the Corporation and the methods of applying these principles conform to generally accepted accounting principles in the United States (“GAAP”). The Corporation’s critical accounting policies relate to: 1) the allowance for loan and lease losses; 2) other-than-temporary impairments (“OTTIs”); 3) income taxes; 4) the classification and values of investment securities; 5) the valuation of financial instruments; 6) income recognition on loans; 7) loans acquired, 8) loans held for sale, and 9) the equity method of accounting for investment in unconsolidated entity. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the amounts recorded for assets and liabilities and for contingent liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates, if different assumptions or conditions prevail. Certain determinations inherently require greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than those originally reported.

The Corporation’s critical accounting policies are described in the Management’s Discussion and Analysis of Financial Condition and Results of Operations included in First BanCorp.’s 2013 Annual Report on Form 10-K. There have not been any material changes in the Corporation’s critical accounting policies since December 31, 2013. Refer to “Credit Risk Management-Allowance for Loan Losses” discussion below for information about enhancements to the allowance for loan losses estimation process implemented during the second quarter of 2014.

## **RESULTS OF OPERATIONS**

### **Net Interest Income**

Net interest income is the excess of interest earned by First BanCorp. on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp.’s net interest income is subject to interest rate risk due to the repricing and maturity mismatch of the Corporation’s assets and liabilities. Net interest income for the quarter and nine-month period ended September 30, 2014 was \$127.7 million and \$388.9 million, respectively, compared to \$130.9 million and \$382.3 million for the comparable periods in 2013. On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments, net interest income for the quarter and nine-month period ended September 30, 2014 was \$131.3 million and \$402.2 million, respectively, compared to \$135.1 million and \$390.0 million for the comparable periods in 2013.

The following tables include a detailed analysis of net interest income. Part I presents average volumes and rates on an adjusted tax-equivalent basis and Part II presents, also on an adjusted tax-equivalent basis, the extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected the Corporation’s net

Supplemental cash flow information is as follows:

interest income. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in volume multiplied by prior period rates), and (ii) changes in rate (changes in rate multiplied by prior period volumes). Rate-volume variances (changes in rate multiplied by changes in volume) have been allocated to the changes in volume and rate based upon their respective percentage of the combined totals.

The net interest income is computed on an adjusted tax-equivalent basis and excluding the change in the fair value of derivative instruments. For a definition and reconciliation of this non-GAAP measure, refer to discussions below.



<b>Part I</b>												
	<b>Average Volume</b>				<b>Interest income <sup>(1)</sup> / expense</b>				<b>Average Rate <sup>(1)</sup></b>			
<b>Quarter ended September 30,</b>	<b>2014</b>		<b>2013</b>		<b>2014</b>		<b>2013</b>		<b>2014</b>		<b>2013</b>	
(Dollars in thousands)												
Interest-earning assets:												
Money market & other short-term investments	\$	744,738	\$	639,285	\$	473	\$	456	0.25	%	0.28	%
Government obligations (2)		339,261		342,739		1,956		2,008	2.29	%	2.32	%
Mortgage-backed securities		1,657,816		1,705,745		11,985		14,847	2.87	%	3.45	%
FHLB stock		26,788		30,884		283		311	4.19	%	4.00	%
Equity securities		320		1,320		-		-	-		-	
Total investments (3)		2,768,923		2,719,973		14,697		17,622	2.11	%	2.57	%
Residential mortgage loans		2,803,138		2,580,758		39,401		37,273	5.58	%	5.73	%
Construction loans		195,108		257,188		1,910		2,141	3.88	%	3.30	%
C&I and commercial mortgage loans		4,434,798		4,755,518		49,043		48,971	4.39	%	4.09	%
Finance leases		237,374		241,256		4,707		5,188	7.87	%	8.53	%
Consumer loans		1,806,158		1,804,892		50,481		55,196	11.09	%	12.13	%
Total loans (4) (5)		9,476,576		9,639,612		145,542		148,769	6.09	%	6.12	%
Total interest-earning assets	\$	12,245,499	\$	12,359,585	\$	160,239	\$	166,391	5.19	%	5.34	%
Interest-bearing liabilities:												
Brokered CDs	\$	3,097,358	\$	3,149,417	\$	7,482	\$	8,295	0.96	%	1.04	%
Other interest-bearing deposits		5,691,643		5,773,400		11,862		13,158	0.83	%	0.90	%
Other borrowed funds		1,131,959		1,131,959		8,675		8,321	3.04	%	2.92	%

Supplemental cash flow information is as follows:

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

FHLB advances		324,674		355,016		949		1,524		1.16	%		1.70	%
Total interest-bearing liabilities	\$	10,245,634	\$	10,409,792	\$	28,968	\$	31,298		1.12	%		1.19	%
Net interest income					\$	131,271	\$	135,093						
Interest rate spread										4.07	%		4.15	%
Net interest margin										4.25	%		4.34	%

<b>Part I</b>												
	<b>Average Volume</b>				<b>Interest income <sup>(1)</sup> / expense</b>				<b>Average Rate <sup>(1)</sup></b>			
<b>Nine-Month Period Ended September 30,</b>	<b>2014</b>		<b>2013</b>		<b>2014</b>		<b>2013</b>		<b>2014</b>		<b>2013</b>	
(Dollars in thousands)												
Interest-earning assets:												
Money market & other short-term investments	\$	739,456	\$	709,240	\$	1,427	\$	1,494	0.26	%	0.28	%
Government obligations (2)		339,295		337,156		6,115		5,847	2.41	%	2.32	%
Mortgage-backed securities		1,691,816		1,642,080		42,268		35,933	3.34	%	2.93	%
FHLB stock		27,724		31,775		897		1,048	4.33	%	4.41	%
Equity securities		320		1,348		-		-	-		-	
Total investments (3)		2,798,611		2,721,599		50,707		44,322	2.42	%	2.18	%
Residential mortgage loans		2,663,641		2,730,842		111,066		112,688	5.57	%	5.52	%
Construction loans		203,359		292,594		5,616		7,032	3.69	%	3.21	%
C&I and commercial mortgage loans		4,638,218		4,787,841		150,828		145,371	4.35	%	4.06	%
Finance leases		242,173		239,407		14,882		15,396	8.22	%	8.60	%
Consumer loans		1,818,628		1,793,811		155,787		166,002	11.45	%	12.37	%
Total loans (4) (5)		9,566,019		9,844,495		438,179		446,489	6.12	%	6.06	%
Total interest-earning assets	\$	12,364,630	\$	12,566,094	\$	488,886	\$	490,811	5.29	%	5.22	%
Interest-bearing liabilities:												
Brokered CDs	\$	3,135,572	\$	3,298,338	\$	22,585	\$	30,566	0.96	%	1.24	%
Other interest-bearing deposits		5,817,613		5,740,514		36,524		40,349	0.84	%	0.94	%

Supplemental cash flow information is as follows:

Other borrowed funds	1,131,959	1,131,959	25,020	24,717	2.96 %	2.92 %
FHLB advances	308,388	376,847	2,606	5,180	1.13 %	1.84 %
Total interest-bearing liabilities	\$ 10,393,532	\$ 10,547,658	\$ 86,735	\$ 100,812	1.12 %	1.28 %
Net interest income			\$ 402,151	\$ 389,999		
Interest rate spread					4.17 %	3.94 %
Net interest margin					4.35 %	4.15 %

- (1) On an adjusted tax-equivalent basis. The adjusted tax-equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate of 39.0% and adding to it the cost of interest-bearing liabilities. The tax-equivalent adjustment recognizes the income tax savings when comparing taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. Therefore, management believes these measures provide useful information to investors by allowing them to make peer comparisons. Changes in the fair value of derivatives are excluded from interest income and interest expense because the changes in valuation do not affect interest paid or received.
- (2) Government obligations include debt issued by government sponsored agencies.
- (3) Unrealized gains and losses on available-for-sale securities are excluded from the average volumes.
- (4) Average loan balances include the average of non-performing loans.
- (5) Interest income on loans includes \$3.1 million and \$3.7 million for the quarters ended September 30, 2014 and 2013, respectively, and \$8.8 million and \$10.8 million for the nine-month periods ended September 30, 2014 and 2013, respectively, of income from prepayment penalties and late fees related to the Corporation's loan portfolio.

<b>Part II</b>												
	<b>Quarter ended September 30,</b>						<b>Nine-Month Period Ended September 30,</b>					
	<b>2014 compared to 2013</b>						<b>2014 compared to 2013</b>					
	<b>Increase (decrease)</b>						<b>Increase (decrease)</b>					
	<b>Due to:</b>						<b>Due to:</b>					
(In thousands)	Volume		Rate		Total		Volume		Rate		Total	
Interest income on interest-earning assets:												
Money market & other short-term investments	\$ 71		\$ (54)		\$ 17		\$ 61		\$ (128)		\$ (67)	
Government obligations	(20)		(32)		(52)		37		231		268	
Mortgage-backed securities	(407)		(2,455)		(2,862)		1,116		5,219		6,335	
FHLB stock	(42)		14		(28)		(131)		(20)		(151)	
Total investments	(398)		(2,527)		(2,925)		1,083		5,302		6,385	
Residential mortgage loans	3,152		(1,024)		2,128		(2,793)		1,171		(1,622)	
Construction loans	(559)		328		(231)		(2,309)		893		(1,416)	
C&I and commercial mortgage loans	(3,396)		3,468		72		(4,725)		10,182		5,457	
Finance leases	(82)		(399)		(481)		175		(689)		(514)	
Consumer loans	18		(4,733)		(4,715)		2,231		(12,446)		(10,215)	
Total loans	(867)		(2,360)		(3,227)		(7,421)		(889)		(8,310)	
Total interest income	(1,265)		(4,887)		(6,152)		(6,338)		4,413		(1,925)	
Interest expense on interest-bearing liabilities:												
Brokered CDs	(135)		(678)		(813)		(1,447)		(6,534)		(7,981)	
Other interest-bearing deposits	(184)		(1,112)		(1,296)		520		(4,345)		(3,825)	
Other borrowed funds	-		354		354		-		303		303	
FHLB advances	(121)		(454)		(575)		(825)		(1,749)		(2,574)	
Total interest expense	(440)		(1,890)		(2,330)		(1,752)		(12,325)		(14,077)	
Change in net interest income	\$ (825)		\$ (2,997)		\$ (3,822)		\$ (4,586)		\$ 16,738		\$ 12,152	

Supplemental cash flow information is as follows:

Portions of the Corporation's interest-earning assets, mostly investments in obligations of some U.S. government agencies and sponsored entities, generate interest which is exempt from income tax, principally in Puerto Rico. Also, interest and gains on sales of investments held by the Corporation's international banking entities ("IBEs") are tax-exempt under the Puerto Rico tax law (refer to the Income Taxes discussion below for additional information). To facilitate the comparison of all interest data related to these assets, the interest income has been converted to an adjusted taxable equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate as adjusted for changes to enacted tax rates (39.0%) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law.

The presentation of net interest income excluding the effects of the changes in the fair value of the derivative instruments ("valuations") provides additional information about the Corporation's net interest income and facilitates comparability and analysis. The changes in the fair value of the derivative instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively, or on interest payments exchanged with interest rate swap counterparties.

The following table reconciles net interest income in accordance with GAAP to net interest income, excluding valuations, and net interest income on an adjusted tax-equivalent basis. The table reconciles net interest spread and net interest margin on a GAAP basis to these items excluding valuations and on an adjusted tax-equivalent basis:

	(Dollars in thousands)											
	Quarter Ended					Nine-Month Period Ended						
	September 30, 2014		September 30, 2013			September 30, 2014		September 30, 2013				
Interest Income - GAAP	\$	156,662		\$	162,203		\$	475,656		\$	483,098	
Unrealized gain on derivative instruments		(418)			(232)			(993)			(1,340)	
Interest income excluding valuations		156,244			161,971			474,663			481,758	
Tax-equivalent adjustment		3,995			4,420			14,223			9,053	
Interest income on a tax-equivalent basis excluding valuations		160,239			166,391			488,886			490,811	
Interest Expense - GAAP		28,968			31,298			86,735			100,812	
Net interest income - GAAP	\$	127,694		\$	130,905		\$	388,921		\$	382,286	
Net interest income excluding valuations	\$	127,276		\$	130,673		\$	387,928		\$	380,946	
Net interest income on a tax-equivalent basis excluding valuations	\$	131,271		\$	135,093		\$	402,151		\$	389,999	
<b>Average Balances</b>												
Loans and leases	\$	9,476,576		\$	9,639,612		\$	9,566,019		\$	9,844,495	
Total securities and other short-term investments		2,768,923			2,719,973			2,798,611			2,721,599	
Average Interest-Earning Assets	\$	12,245,499		\$	12,359,585		\$	12,364,630		\$	12,566,094	
Average Interest-Bearing Liabilities	\$	10,245,634		\$	10,409,792		\$	10,393,532		\$	10,547,658	
<b>Average Yield/Rate</b>												
		5.08	%		5.21	%		5.14	%		5.14	%

Supplemental cash flow information is as follows:

Average yield on interest-earning assets - GAAP														
Average rate on interest-bearing liabilities - GAAP		1.12	%		1.19	%		1.12	%		1.28	%		
Net interest spread - GAAP		3.96	%		4.02	%		4.02	%		3.86	%		
Net interest margin - GAAP		4.14	%		4.20	%		4.21	%		4.06	%		
Average yield on interest-earning assets excluding valuations		5.06	%		5.20	%		5.13	%		5.12	%		
Average rate on interest-bearing liabilities excluding valuations		1.12	%		1.19	%		1.12	%		1.28	%		
Net interest spread excluding valuations		3.94	%		4.01	%		4.01	%		3.84	%		
Net interest margin excluding valuations		4.12	%		4.19	%		4.19	%		4.05	%		
Average yield on interest-earning assets on a tax-equivalent basis														
and excluding valuations		5.19	%		5.34	%		5.29	%		5.22	%		
Average rate on interest-bearing liabilities excluding valuations		1.12	%		1.19	%		1.12	%		1.28	%		
Net interest spread on a tax-equivalent basis and excluding valuations		4.07	%		4.15	%		4.17	%		3.94	%		
Net interest margin on a tax-equivalent basis and excluding valuations		4.25	%		4.34	%		4.35	%		4.15	%		



Interest income on interest-earning assets primarily represents interest earned on loans held for investment and investment securities.

Interest expense on interest-bearing liabilities primarily represents interest paid on brokered CDs, branch-based deposits, repurchase agreements, advances from the FHLB and notes payable.

Unrealized gains or losses on derivatives represent changes in the fair value of derivatives, primarily interest rate swaps and caps used for protection against rising interest rates.

Derivative instruments, such as interest rate swaps, are subject to market risk. While the Corporation does have certain trading derivatives to facilitate customer transactions, the Corporation does not utilize derivative instruments for speculative purposes. As of September 30, 2014, most of the interest rate swaps outstanding are used for protection against rising interest rates, although not designated as hedges. Refer to Note 9 of the accompanying unaudited consolidated financial statements for further details concerning the notional amounts of derivative instruments and additional information. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on net interest income. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future.

Net interest income for the third quarter of 2014 amounted to \$127.7 million, a decrease of \$3.2 million, when compared to \$130.9 million for the third quarter of 2013. The net interest margin, excluding valuations, decreased by 7 basis points to 4.12% compared to the third quarter of 2013. The decrease in net interest income and margin was primarily driven by lower yields on consumer loans and MBS investments, partially offset by a decrease in the overall cost of funding.

The average yield of consumer loans (including finance leases) decreased to 10.71% for the third quarter of 2014, from 11.71% for the same period in 2013, for an adverse impact of approximately \$5.1 million in interest income. The decline in the average yield reflects both the impact of lower rates on new loan originations given the current level of interest rates and the fact that the remaining discount of the credit card portfolio acquired in 2012 was fully accreted into income during the first half of 2014. The discount accretion included in interest income in the prior year third quarter was \$2.3 million.

In addition, the net interest income and margin were adversely impacted by a 50 basis point reduction in the average yield of MBS investments, or a decrease in interest income of approximately \$2.1 million, mainly reflecting the gradual reinvestment of MBS prepayments in lower-yielding investments given the low interest rate environment or

Supplemental cash flow information is as follows:

the deposit of such prepayments in cash balances maintained at the Federal Reserve Bank.

The \$114.1 million decrease in the volume of total average earning assets had an adverse impact of approximately \$1.3 million.

The aforementioned adverse impacts were partially offset by a decrease in the average cost of funding and increased interest income of residential mortgage loans reflecting the full quarter impact of the acquisition of mortgage loans from Doral Financial Corporation (“Doral”) in full satisfaction of secured borrowings on May 30, 2014. The interest income recorded on such loans in the third quarter of 2014 was approximately \$2.7 million higher than the interest income recorded in the third quarter of 2013 on Doral’s previous commercial secured borrowings.

The Corporation reduced the average cost of funds as a result of lower rates paid on savings, interest-bearing checking accounts, and retail and brokered CDs. For the quarter ended September 30, 2014, the average rate paid on non-brokered deposits decreased by 7 basis points to 0.83% compared to the third quarter of 2013. The average balance of non-brokered deposits for the quarter ended September 30, 2014 decreased by \$81.8 million to \$5.7 billion, compared to the same period in 2013, primarily reflecting the full quarter impact of government deposit withdrawals by public corporations in Puerto Rico in the latter part of the second quarter of 2014. These reductions resulted in a decline of \$1.3 million in interest expense for the third quarter of 2014, when compared to the same period in 2013.

The average cost of brokered CDs decreased by 8 basis points for the quarter ended September 30, 2014, as compared to the same period in 2013, and the average balance of brokered CDs for the third quarter of 2014 decreased by \$52.1 million, compared to the same period in 2013. These reductions resulted in a decline of \$0.8 million in interest expense for the third quarter of 2014, when compared to the same period in 2013. Over the past 12 months, the Corporation repaid approximately \$1.7 billion of maturing brokered CD's with an all-in cost of 0.85% and issued \$1.6 billion of new brokered CD's with an all-in cost of 0.81%.

The decrease in the overall cost of funding also reflects maturities of some high-cost borrowings; over the past 12 months, the Corporation repaid approximately \$53.4 million of FHLB advances with an all-in cost of 4.94% and issued \$25 million of new FHLB advances with an all-in cost of 1.79%. This represented a decrease of approximately \$0.6 million in interest expense for the third quarter of 2014 compared to the same period in 2013, partially offset by the contractual repricing of a \$100 million structured repurchase agreement that resulted in an increase of approximately \$0.4 million in interest expense.

On an adjusted tax-equivalent basis, net interest income for the quarter ended September 30, 2014 decreased \$3.8 million to \$131.3 million when compared to the same period in 2013. The decrease was mainly due to lower yields on MBS investments and consumer loans as discussed above. The decrease for the 2014 period also includes a decrease of \$0.4 million in the tax-equivalent adjustment. The tax-equivalent adjustment increases interest income on tax-exempt securities and loans by an amount that makes tax-exempt income comparable, on a pre-tax basis, to the Corporation's taxable income as previously stated.

Net interest income for the nine-month period ended September 30, 2014 amounted to \$388.9 million, an increase of \$6.6 million, when compared to \$382.3 million for the same period in 2013. The net interest margin, excluding valuations, increased by 14 basis points to 4.19% compared to the first nine months of 2013. The increase in net interest income and margin was primarily driven by a reduction in the average cost of funds and an increase in the average yield of MBS investments.

The average cost of brokered CDs decreased by 28 basis points for the nine-month period ended September 30, 2014, as compared to the same period in 2013, and the average balance of brokered CDs for the first nine months of 2014 decreased by \$162.8 million, compared to the same period in 2013. These reductions resulted in a decline of \$8.0

million in interest expense for the first nine months of 2014, when compared to the same period in 2013.

For the nine-month period ended September 30, 2014, the average rate paid on non-brokered deposits decreased by 10 basis points to 0.84% compared to the same period in 2013. The average balance of non-brokered deposits for the nine-month period ended September 30, 2014 increased by \$77.1 million to \$5.8 billion, compared to the same period in 2013. These variances resulted in a net decrease of \$3.8 million in interest expense for the first nine months of 2014, when compared to the same period in 2013.

The decrease in interest expense related to maturities of high-cost FHLB advances was approximately \$2.6 million for the nine-month period ended September 30, 2014 compared to the same period in 2013.

In contrast to the variance discussed above for the comparison between quarters, the average yield of MBS investments increased by approximately 18 basis points, or an increase of approximately \$2.3 million in interest income, for the first nine months of 2014 compared to the same period in 2013 mainly due to lower U.S. agency MBS prepayment levels prevailing in the first half of 2014 that resulted in a reduction in the premium amortization expense. In addition, for the first nine months of 2014, the average volume of MBS investments increased by \$49.7 million to \$1.7 billion compared to the same period in 2013 mainly as a result of purchases over the last 18 months of approximately \$312.9 million of 10-15 year U.S. agency MBS with an average yield of 2.40%.

The aforementioned favorable variances were partially offset by a decrease of \$10.5 million in interest income on credit cards for the first nine months of 2014 reflecting both lower volume and yield, including a \$3.5 million reduction related to the full discount accretion discussed above. This was partially offset by increased interest income for the first nine months of 2014 of approximately \$3.5 million related to the higher income recorded in 2014 for the residential mortgage loans acquired from Doral compared to the income recorded for the previously held Doral commercial secured borrowings in 2013. Refer to “Provision and Allowance for Loan and Lease Losses” discussion below for additional information about this transaction completed in the second quarter of 2014.

On an adjusted tax-equivalent basis, net interest income for the nine-month period ended September 30, 2014 increased \$12.2 million to \$402.2 million when compared to the same period in 2013. The increase was mainly due to the decrease in the average cost of funding and higher yields on U.S. agency MBS as discussed above. The increase for the 2014 period also includes an increase of \$5.2 million in the tax-equivalent adjustment driven by a higher volume and yield of tax-exempt investment securities and loans.

### **Provision and Allowance for Loan and Lease Losses**

The provision for loan and lease losses is charged to earnings to maintain the allowance for loan and lease losses at a level that the Corporation considers adequate to absorb probable losses inherent in the portfolio. The adequacy of the allowance for loan and lease losses is also based upon a number of additional factors, including trends in charge-offs and delinquencies, current economic conditions, the fair value of the underlying collateral and the financial condition of the borrowers, and, as such, includes amounts based on judgments and estimates made by the Corporation. Although the Corporation believes that the allowance for loan and lease losses is adequate, factors beyond the Corporation’s control, including factors affecting the economies of Puerto Rico, the United States, the U.S. Virgin Islands and the British Virgin Islands, may contribute to delinquencies and defaults, thus necessitating additional reserves.

For the quarter ended September 30, 2014, the Corporation recorded a provision for loan and lease losses of \$27.0 million compared to \$22.2 million for the comparable period in 2013. The increase was mainly due to higher net charge-offs of C&I loans, the increase in the general reserve for certain commercial credits that migrated to a different loan classification, and a higher general reserve for auto and small personal loans due to higher net charge-off levels and adjustments to account for general economic conditions. These variances were partially offset by higher recoveries of amounts previously charged-off, primarily related to the commercial mortgage and construction loan

Supplemental cash flow information is as follows:

portfolios in Florida.

In terms of geography and categories, in Puerto Rico, the Corporation recorded a provision of \$32.8 million for the third quarter of 2014 compared to \$25.7 million for the same period in 2013. The provision for commercial and construction loans in Puerto Rico increased by \$4.4 million reflecting an increase of approximately \$19.1million related primarily to increases in net charge-offs on C&I loans and the increase in the general reserve for certain commercial credits that migrated to a different loan classification, partially offset by a decrease of approximately \$14.7 million related to several factors including, a specific reserve required for a commercial and industrial loan determined to be impaired during the third quarter of 2014 that was lower than the estimated loss previously reflected as part of the general reserve, recoveries of previously charge-off amounts on construction loans and lower general reserves due to, among other things, a decrease in the size of these portfolios. The provision for consumer loans increased by \$3.4 million primarily related to increases in the general reserve of auto and small personal loans due to an increase in net charge-offs and adjustments to account for general economic conditions.

With respect to the portfolio in the United States, the Corporation continued to see improvements in terms of recoveries of amounts previously charged-off, stability of collateral values and reductions in adversely classified assets. For the third quarter of 2014, the Corporation recorded a negative provision for loan losses of \$6.8 million compared to a negative provision of \$2.5 million for the third quarter of 2013. Recoveries of amounts previously charged-off in Florida increased to \$6.5 million in the third quarter of 2014, compared to \$0.1 million in 2013, primarily related to commercial mortgage and construction loans. The following table sets forth a detail of the charge-offs and recoveries recorded in the Florida region for the third quarter of 2014 and 2013:

	Quarter Ended September 30,			
	2014		2013	
	(In thousands)			
Charge-offs	\$	(196)	\$	(5,537)
Recoveries		6,470		77
Net recoveries (charge-offs)	\$	6,274	\$	(5,460)

The Virgin Islands region recorded a provision of \$1.0 million for the third quarter of 2014 compared to a negative provision of \$1.1 million for the same period in 2013. The variance mainly reflects the impact in 2013 of a \$1.8 million recovery on the sale of the underlying collateral of a construction project and an increase of \$0.7 million in the provision for residential mortgage loans.

For the nine-month period ended September 30, 2014, the Corporation recorded a provision for loan and lease losses of \$85.7 million compared to \$220.8 million for the comparable period in 2013. The fair value adjustments related to mortgage loans acquired from Doral added \$1.4 million to the provision for loan losses in the first nine months of 2014, and the bulk sale of assets and transfer of certain commercial loans to held for sale during 2013 added \$132.0 million to the provision for loan losses in the first nine months of 2013.

On May 30, 2014, FirstBank purchased from Doral all of its rights, title and interests in first and second mortgage loans having an unpaid principal balance of approximately \$241.7 million for an aggregate price of approximately \$232.9 million. Doral had pledged the mortgage loans to FirstBank as collateral for secured borrowings pursuant to a series of credit agreements between the parties entered into in 2006. As consideration for the purchase of the mortgage loans, FirstBank credited approximately \$232.9 million as full satisfaction of the outstanding balance of the Doral secured borrowing plus interest owed to FirstBank. The estimated fair value of the mortgage loans at acquisition was \$226.0 million. This transaction resulted in a loss of \$6.9 million derived from the difference between the fair value of the mortgage loans acquired, \$226.0 million, and the book value of the secured borrowings of \$232.9 million. Approximately \$5.5 million of the loss was part of the general allowance for loan losses established for commercial loans in prior periods; thus, an additional charge of \$1.4 million to the provision was recorded in 2014.





The following table shows a reconciliation of certain non-GAAP financial measures ("adjusted net charge-offs" and "adjusted provision for loan losses"), which reflects the exclusion of the impact of the Doral transaction, at acquisition, with the corresponding measures calculated and presented in accordance with GAAP:								
(Dollars in thousands)								
Nine Month period ended September 30, 2014			As Reported (GAAP)	Loss on Acquisition of Mortgage Loans from Doral			Adjusted, excluding Loss on Acquisition of Mortgage Loans from Doral (Non-GAAP)	
<b>Total net charge-offs (1)</b>			\$	<b>146,082</b>	\$	<b>6,908</b>	\$	<b>139,174</b>
Total net charge-offs to average loans				2.04%				1.94%
Commercial and Industrial				57,263		6,908		50,355
Commercial and Industrial loans net charge-offs to average loans				2.72%				2.51%
<b>Provision for loan and lease losses</b>			\$	<b>85,658</b>	\$	<b>1,428</b>	\$	<b>84,230</b>
1 - Charge-off percentages annualized								

The Corporation completed two bulk sales of assets in 2013, including: (i) a bulk sale of non-performing residential mortgage loans with a book value of \$203.8 million and OREO properties with a book value of \$19.2 million, completed in the second quarter of 2013, and (ii) a bulk sale of adversely classified assets, mainly commercial and construction loans, with a book value of \$211.4 million and OREO properties with a book value of \$6.3 million, completed in the first quarter of 2013. In addition, during the first quarter of 2013, the Corporation transferred to held for sale non-performing loans with an aggregate book value of \$181.6 million. The following tables summarize the impact of the bulk sales of assets and the transfer of loans to held for sale completed in 2013 on net charge-offs and provision for loan and lease losses for the nine-month period ended September 30, 2013:

(Dollars in thousands)										
Nine-Month Period Ended September 30, 2013	As Reported (GAAP)	Bulk Sales Transaction Impact		Loans Transferred To Held For Sale Impact		Excluding Bulk Sales and Loans Transferred To Held For Sale Impact (Non-GAAP)				
<b>Total net charge-offs (1)</b>	<b>\$ 366,817</b>		<b>\$ 196,491</b>		<b>\$ 35,953</b>	<b>\$ 134,373</b>				
Total net charge-offs to average loans	4.97%					1.87%				
Residential mortgage	123,455		98,972		-	24,483				
Residential mortgage loans net charge-offs to average loans	6.03%					1.26%				
Commercial mortgage	65,207		40,057		14,553	10,597				
Commercial mortgage loans net charge-offs to average loans	4.80%					0.81%				
Commercial and Industrial	96,067		44,678		-	51,389				
Commercial and Industrial loans net charge-offs to average loans	4.30%					2.33%				
Construction	40,812		12,784		21,400	6,628				
Construction loans net charge-offs to average loans	18.60%					3.50%				
<b>Provision for loan and lease losses</b>	<b>\$ 220,782</b>		<b>\$ 126,780</b>		<b>\$ 5,222</b>	<b>\$ 88,780</b>				
Residential mortgage	86,888		68,838		-	18,050				
Commercial Mortgage	49,551		29,753		(1,033)	20,831				
Commercial & Industrial	32,216		20,766		-	11,450				
Construction	15,315		7,423		6,255	1,637				

Supplemental cash flow information is as follows:

l - Charge-off percentages annualized												

The adjusted provision for loan and lease losses, excluding the impact of the Doral transaction in 2014 and the bulk sales of assets and transfer of certain commercial loans to held for sale, decreased by \$4.6 million in the first nine months of 2014, as compared to the same period in 2013, mainly related to higher negative provisions in the United States region driven by higher recoveries, reductions related to updated appraisals, and the decrease in the overall amount of adversely classified assets. In addition, the decrease for the first nine months of 2014 reflects lower provision requirements for the Puerto Rico residential mortgage loan portfolio driven by an improved portfolio composition following the sale of non-performing residential assets completed in 2013.

In term of geography and categories, the Corporation recorded a provision for loan and lease losses of \$107.8 million in Puerto Rico for the first nine months of 2014 compared to \$217.9 million for the same period in 2013. Excluding the impact of fair value adjustments related to mortgage loans acquired from Doral in 2014 and the bulk sales of assets and the transfer of loans to held for sale in 2013, the adjusted provision for loan and lease losses in Puerto Rico increased by \$9.0 million. The variance reflects a \$21.1 million increase in the provision for consumer loans mainly due to higher charge-offs and adjustments to account for general economic conditions that affected the auto and personal loans portfolio, partially offset by a decrease in the provision for credit card loans tied to the decrease in size of this portfolio. This increase was partially offset by a \$7.1 million reduction in the provision for residential mortgage loans driven by an improved portfolio composition following the sale of non-performing residential assets in 2013 and a \$5.0 million decrease in the commercial and construction portfolio mainly related to updated appraisals in commercial mortgage loans and some recoveries of amounts previously charged-off of construction loans.

In the United States, the Corporation recorded a negative provision of \$23.2 million for the first nine months of 2014 compared to a negative provision of \$4.9 million for the same period in 2013. As described above, higher negative provisions in 2014 are primarily related to recoveries, releases related to updated appraisals and a lower level of adversely classified assets related to the commercial and construction portfolios. The following table sets forth a detail of the charge-offs and recoveries recorded in the Florida region for the first nine months of 2014 and 2013:

	Nine month Period Ended September 30,			
	2014		2013	
	(In thousands)			
Charge-offs	\$	(1,179)	\$	(8,026)
Recoveries		11,406		249
Net recoveries (charge-offs)	\$	10,227	\$	(7,777)

The Virgin Islands region recorded a provision for loan losses of \$1.1 million for the first nine months of 2014 compared to \$7.8 million in the same period of 2013. The decrease in the provision was mainly due to the portion of losses of the bulk sale of non-performing residential assets and the transfer of loans to held for sale in 2013 attributable to the Virgin Islands portfolio. Excluding the impact of the bulk sales of non-performing residential assets

Supplemental cash flow information is as follows:

and the transfer of loans to held for sale in 2013, the adjusted provision for loan and lease losses in the Virgin Islands increased by \$4.8 million distributed among all major loan categories.

Refer to the discussions under “Credit Risk Management” below for an analysis of the allowance for loan and lease losses, non-performing assets, impaired loans and related information, including information about enhancements to the allowance for loan losses estimation process implemented during the second quarter of 2014, and refer to the discussions under “Financial Condition and Operating Analysis – Loan Portfolio” and under “Risk Management — Credit Risk Management” below for additional information concerning the Corporation’s loan portfolio exposure in the geographic areas where the Corporation does business.

Non-Interest Income (Loss)									
		Quarter Ended				Nine-Month Period Ended			
		September 30,				September 30,			
		2014		2013		2014		2013	
		(In thousands)							
	Service charges on deposit accounts	\$	3,235	\$	3,157	\$	9,728	\$	9,635
	Mortgage banking activities		3,809		3,521		10,213		12,924
	Insurance income		1,290		1,303		5,328		4,831
	Broker-dealer income		-		-		459		-
	Other operating income		8,085		7,987		24,961		22,167
	Non-interest income before net (loss) gain on investments, equity in (loss) earnings of unconsolidated entity, and write-off of collateral pledged to Lehman		16,419		15,968		50,689		49,557
	Net gain on sale of investments		-		-		291		-
	OTTI on equity securities		-		-		-		(42)
	OTTI on debt securities		(245)		-		(245)		(117)
	Net (loss) gain on investments		(245)		-		46		(159)
	Impairment - collateral pledged to Lehman		-		-		-		(66,574)
	Equity in (loss) earnings of unconsolidated entity		-		(5,908)		(7,280)		(10,798)
	Total	\$	16,174	\$	10,060	\$	43,455	\$	(27,974)

Non-interest income primarily consists of service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains and losses on mortgage banking activities; interchange and other fees related to debit and credit cards; equity in earnings (losses) of unconsolidated entities; and net gains and losses on investments and impairments.

Service charges on deposit accounts include monthly fees, overdraft fees and other fees on deposit accounts.

Supplemental cash flow information is as follows:

Income from mortgage banking activities includes gains on sales and securitization of loans, revenues earned for administering residential mortgage loans originated by the Corporation and subsequently sold with servicing retained, and unrealized gains and losses on forward contracts used to hedge the Corporation's securitization pipeline. In addition, lower-of-cost-or-market valuation adjustments to the Corporation's residential mortgage loans held for sale portfolio and servicing rights portfolio, if any, are recorded as part of mortgage banking activities.

Insurance income consists of insurance commissions earned by the Corporation's subsidiary, FirstBank Insurance Agency, Inc.

Broker-dealer income consists of commissions earned from the Corporation's broker-dealer subsidiary activities, FirstBank Puerto Rico Securities.

The other operating income category is composed of miscellaneous fees such as debit, credit card and point of sale (POS) interchange fees and check and cash management fees.

The net gain (loss) on investment securities reflects gains or losses as a result of sales that are consistent with the Corporation's investment policies as well as other-than-temporary ("OTTI") charges on the Corporation's investment portfolio.

Equity in earnings (losses) of unconsolidated entity relates to FirstBank's investment in CPG/GS, the entity that purchased \$269 million of loans from FirstBank during the first quarter of 2011. The Bank holds a 35% subordinated ownership interest in CPG/GS. The majority owner of CPG/GS is entitled to recover its initial investment and a priority return of 12% prior to any return paid to the Bank. The adjustments of \$7.3 million recorded in the first half of 2014 reduced to zero the book value of the Bank's investment in CPG/GS as of September 30, 2014. No negative investments needs to be reported as the Bank has no legal obligation or commitment to provide further financial support to this entity; thus, no further losses will be recorded on this investment. Any potential increase in the carrying value of the investment in CPG/GS, under the Hypothetical Liquidation Book Value method, would depend upon how better off the Bank is at the end of the period than it was at the beginning of the period after the waterfall calculation performed to determine the amount of gain allocated to the investors. Refer to Note 12 of the Corporation's unaudited financial statements for the quarter ended September 30, 2014 for additional information about the Bank's investment in CPG/GS.

Non-interest income for the third quarter of 2014 amounted to \$16.2 million, compared to \$10.1 million for the third quarter of 2013 primarily due to the following:

- A positive variance of \$5.9 million related to the accounting for the Bank's investment in CPG/GS.
- A \$0.3 million increase in revenues from mortgage banking activities driven by a \$1.7 million decrease in mark-to-market losses on TBA MBS forward contracts used to hedge the securitization pipeline, partially offset by a \$1.3 million decrease in net gains on sales of residential mortgage loans to government-sponsored entities as a result of a lower volume of sales and securitizations. Loan sales and securitizations for the third quarter of 2014 of \$75.1 million resulted in a gain of \$2.7 million, compared to sales and securitizations of \$209.3 million and a related gain of \$4.0 million recorded in the third quarter of 2013.

This was partially offset by:

- A \$0.2 million OTTI on private label MBS.

Non-interest income for the nine-month period ended September 30, 2014 amounted to \$43.5 million, compared to non-interest loss of \$28.0 million for the same period in 2013, including the \$66.6 million write-off of the collateral pledged to Lehman that was recorded in the second quarter of 2013. Adjusted non-interest income, excluding the Lehman collateral write-off, increased \$4.9 million for the first nine months of 2014 compared to the same period in 2013 primarily due to:

Supplemental cash flow information is as follows:



- A \$3.5 million decrease in equity in (losses) of unconsolidated entities, as the Corporation recorded equity in loss of \$7.3 million for the first nine months of 2014 compared to a loss of \$10.8 million for the first nine months of 2013.
  
- A \$2.8 million positive variance in other operating income mainly due to the impact in 2013 of a \$3.4 million loss related to the restructuring of a commercial mortgage loan held for sale in which the Corporation received foreclosed real estate in partial satisfaction of a debt arrangement and modified the terms of the remaining balance. This loss is included as part of “Other operating income” for the nine-month period ended September 30, 2013 in the table above.

- A \$0.5 million increase in non-interest income related to underwriting fees on a bond issuance of the Puerto Rico government early in 2014.
- A \$0.5 million increase in insurance commission income.
- A \$0.3 million increase related to the gain on sale of a \$4.6 million Puerto Rico government agency bond.

Partially offset by:

- A \$2.7 million decrease in revenues from mortgage banking activities driven by a \$4.1 million decrease in net gains on sales of loans as a result of a lower volume of sales and securitizations and a \$0.8 million increase in expenses related to representations and warranties losses and compensatory fees imposed by government-sponsored agencies. In addition, there was a \$0.4 million decrease in servicing fees reflecting the expiration of the interim servicing on loans included in the bulk sales of 2013. Loan sales and securitizations for the first nine months of 2014 of \$245.5 million resulted in a realized gain of \$8.6 million, compared to sales and securitizations of \$490.1 million and a related realized gain of \$12.7 million recorded in the first nine months of 2013. These variances were partially offset by the positive variance resulting from the impact in the first half of 2013 of a \$1.8 million lower of cost or market valuation charge on residential mortgage loans held for sale.

<b>Non-Interest Expenses</b>									
The following table presents the detail of non-interest expenses for the periods indicated:									
	<b>Quarter Ended September 30,</b>				<b>Nine-Month Period Ended September 30,</b>				
	<b>2014</b>		<b>2013</b>		<b>2014</b>		<b>2013</b>		
	(In thousands)								
Employees' compensation and benefits	\$	33,964	\$	32,823	\$	101,929	\$	99,493	
Occupancy and equipment		14,727		15,109		43,527		45,062	
Insurance and supervisory fees		9,493		11,513		31,267		37,018	
Taxes, other than income taxes		4,528		4,718		13,607		14,009	
Professional fees:									
		2,685		2,780		6,624		9,123	

Supplemental cash flow information is as follows:

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

	Collections, appraisals and other credit related fees									
	Outsourcing technology services		4,840			4,338			13,664	9,942
	Other professional fees		4,008			4,722			12,656	17,642
	Credit and debit card processing expenses		3,741			2,682			11,447	8,040
	Business promotion		3,925			3,538			12,040	10,726
	Communications		2,143			1,866			5,916	5,565
	Net loss on OREO and OREO operations		4,326			7,052			16,941	29,191
	Other		5,224			8,013			14,916	22,676
		\$	93,604		\$	99,154		\$	284,534	\$ 308,487

Non-interest expenses decreased by \$5.6 million to \$93.6 million for the third quarter of 2014 compared to \$99.2 million for the third quarter of 2013. The decrease was principally attributable to:

- A \$2.7 million decrease in the net loss on OREO and OREO operations driven by lower write-downs to the value of OREO properties. Total write-downs in the third quarter of 2014 amounted to \$2.8 million compared to \$5.1 million for the third quarter of 2013, a decrease of \$2.3 million. In addition, the decrease reflects lower operating expenses on a reduced inventory and higher rental income.
- A \$2.1 million decrease in the FDIC deposit insurance premium expense reflecting, among other things, improvements in liquidity, reductions in high-risk commercial loan balances as defined in regulatory guidelines, a strengthened capital position and improved trends in earnings. This expense is included as part of “Insurance and supervisory fees” in the table above.
- A \$1.7 million decrease in non-interest expenses associated with the secondary offering of the Corporation’s common stock by certain of the existing stockholders that occurred in the third quarter 2013, primarily included as part of “Other” expenses in the table above.
- The impact in 2013 of \$1.7 million in expenses related to the conversion of the credit card processing platform, primarily included as part of “Other” in the table above.

These decreases were partially offset by:

- A \$1.1 million increase in employee’s compensation and benefits due to salary merit increases in the first half of 2014, higher stock-based compensation expense, and lower capitalized costs associated with loan originations, partially offset by a decrease in incentive-based compensation.
- A \$0.7 million increase related to professional fees specifically attributable to the most recent acquisition of mortgage loans from Doral.

Non-interest expenses decreased by \$24.0 million to \$284.5 million for the nine-month period ended September 30, 2014, compared to \$308.5 million for the same period in 2013, primarily due to:

Supplemental cash flow information is as follows:

- A \$12.3 million decrease in the net loss on OREO and OREO operations mainly related to lower write-downs and losses on the sale of OREO properties and to a lesser extent lower net operating expenses. Total write-downs and losses on sales amounted to \$12.6 million for the first nine months of 2014 compared to \$21.9 million for the same period in 2013, a decrease of \$9.3 million. This variance primarily reflects a decrease of \$6.6 million in market value adjustments, mainly driven by the impact in the second quarter of 2013 of \$5.3 million in write-downs to the value of certain commercial OREO properties in the Virgin Islands, and the impact in 2013 of a \$1.9 million loss on the sale of certain OREO properties as part of the bulk sale of non-performing residential assets. In addition, operating expenses decreased by approximately \$3.0 million primarily related to reductions in taxes, maintenance and repairs consistent with the decrease in the inventory and higher rental income.
- A \$5.7 million decrease in the FDIC deposit insurance premium expense reflecting, among other things, a decrease in total average assets, improvements in earnings trends, higher liquidity, strengthened capital, and a decrease in high-risk loans as defined in regulatory guidelines. This expense is included as part of “Insurance and supervisory fees” in the table above.

- A \$3.8 million decrease in professional fees. This variance reflects the impact of \$6.9 million in professional fees related to the bulk sales of assets completed during the first and second quarter of 2013 and the impact of \$1.2 million in professional fees associated with a terminated preferred stock exchange offer in the first quarter of 2013. These decreases were partially offset by an increase of \$3.7 million in professional services related to the outsourcing of technology services, mainly due to services provided by FIS under a multi-year technology outsourcing agreement executed by the Corporation at the beginning of the second quarter of 2013 and to a lesser an extent an increase of \$1.2 million of professional fees incurred in the two acquisitions of the mortgage loans from Doral in 2014.
- A \$1.7 million decrease in non-interest expenses associated with the secondary offering of the Corporation's common stock by certain of the existing stockholders that occurred in the third quarter 2013, primarily included as part of "Other" in the table above.
- A \$1.7 million decrease of costs associated with the conversion of the credit card processing platform in 2013, primarily included as part of "Other" in 2013.
- A \$1.5 million decrease in occupancy and equipment mainly related to a decrease in the depreciation expense attributable to assets fully depreciated, and a \$0.5 million decrease in property tax expenses related to a tax debt settlement.

These decreases were partially offset by:

- A \$3.4 million increase in credit and debit card processing fees attributable to higher credit card processing costs. The increase mainly reflects the impact in the second quarter of 2013 of \$1.4 million of contractual discounts provided for under the previous interim servicing contract of the credit card portfolio purchased in May 2012. The Corporation completed the conversion of the credit card platform in the third quarter of 2013.
- A \$2.4 million increase in employees' compensation and benefits due to salary merit increases in the first half of 2014, higher stock-based compensation expense, and lower capitalized costs associated with loan originations.

## **Income Taxes**

Supplemental cash flow information is as follows:

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp. is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 PR Code"), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss ("NOL"), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

On June 30, 2013, the Puerto Rico Government approved Act No. 40 (“Act 40”), known as the “Tax Burden Adjustment and Redistribution Act”, which amended the 2011 PR Code, and Act No. 46 (“Act 46”), which enacted changes to the sales and use tax regime. The main provisions of Act 40 that impact financial institutions are:

(i) A new national gross receipts tax that in the case of financial institutions is 1% of gross income that is not deductible for purposes of computing net taxable income and is not part of the alternative minimum tax (“AMT”). This provision was retroactive to January 1, 2013. The national gross receipts tax expense for the quarter and nine-month period ended September 30, 2014 amounted to \$1.4 million and \$4.3 million, respectively, compared to \$1.7 million and \$4.9 million recorded for the third quarter and first nine months of 2013, respectively. This expense is included as part of “Taxes, other than income taxes” in the consolidated statement of income (loss). Subject to certain limitations, a financial institution will be able to claim a credit of 0.5% of its gross income against its regular income tax or the AMT. A benefit related to this credit of \$0.7 million and \$2.1 million was recorded as a reduction to the provision for income taxes in the third quarter and first nine months of 2014, respectively, compared to the benefit of \$0.8 million and \$2.5 million recorded in the third quarter and first nine months of 2013, respectively.

(ii) A decrease in the deduction available to corporations for the computation of the additional surtax from \$750,000 to \$25,000 and a change in the surtax rate to rates that range from 5% to 19%, resulting in an increase in the maximum statutory tax rate from 30% to 39%. This provision was also retroactive to January 1, 2013.

(iii) A higher AMT rate (30% of the alternative minimum net income, as compared to 20% previously) and various parallel computations required to be made before determining whether an AMT liability exists.

(iv) The NOL carryover period increased from 10 years to 12 years for losses incurred in taxable years that commenced after December 31, 2004 and ended before January 1, 2013. The carryover period for NOLs incurred during taxable years commencing after December 31, 2012 is 10 years. The NOL deduction is now limited to 90% of taxable income for regular income tax purposes and 80% for AMT purposes.

Significant changes to the sales and use tax regime include adjustments to the Business to Business exclusion. The business to business exclusion applicable to services rendered from one registered business to another registered business remains in effect, except for certain services that will be taxable, including, among others, service charges imposed by financial institutions on other businesses (commercial clients), collection services, repairs and maintenance services related to real and personal property, and computer programming services, including modifications to previously designed systems. The sales and use tax provisions were effective beginning on July 1, 2013.

On October 14, 2013, the Governor of Puerto Rico signed into law Act No. 117 (“Act 117”) providing additional changes and transitional provisions in connection with Act 40. In relation to the national gross receipts tax, Act 117 clarifies, among other things, that gross income subject to the special tax does not include the following:



(i) Dividends received from a 100% controlled domestic subsidiary. During the first nine months of 2014, no dividends subject to this exception were received by any of the Corporation's entities.

(ii) Income attributable to a trade or business outside of Puerto Rico.

On July 1, 2014, the Puerto Rico Government approved Act No. 77 ("Act 77"), Act for Adjustments to Tax System, which amended the 2011 PR Code. Some of the main provisions that impact corporations follow:

(i) Long Term Capital Gain Tax Rate is increased from 15% to 20% and Long Term Capital Treatment was amended to apply only to assets held for a period of 1 year or more (previously 6 months or more) for transactions completed after June 30, 2014. As a result of this change, the deferred tax liability related to unrealized gains of available for sale securities was increased by \$0.3 million and other deferred tax assets related to capital losses were increased by \$0.1 million.

(ii) New Capital Loss carryover limitation, of up to 90% of Capital Gains and the carryover period of NOL's attributable to capital losses incurred during taxable years commencing after December 31, 2013 was increased from 5 years to 7 years.

(iii) The credit for AMT paid in previous years will be limited to 25% of the excess of the regular income tax over the tentative minimum tax.

(iv) The national gross receipts tax rate for financial institutions was not affected by Act 77 and remains at 1% and financial institutions continue to claim 0.5% of their gross income as a credit against regular income tax or the AMT. However, tax credits purchased or generated by the institution are not allowed as a credit against the national gross receipts tax obligation.

None of these provisions of Act 77 had a material impact on the Corporation in 2014.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through an IBE of the Bank and through the Bank's subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation. The IBE and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at normal rates to the extent that the IBE's net income exceeds 20% of the bank's total net taxable income.

For the quarter and nine-month period ended September 30, 2014, the Corporation recorded an income tax expense of \$0.1 million and \$0.7 million, respectively, compared to an income tax expense of \$3.7 million and \$4.3 million, respectively, for the same periods in 2013. The variance in the third quarter of 2014 compared to the same period in 2013 was mainly driven by an increase of \$3.1 million in 2013 to the reserve for uncertain tax positions and, to a lesser extent, lower taxable income from profitable subsidiaries. The decrease in the income tax expense for the

Supplemental cash flow information is as follows:

nine-month period comparison mainly reflects a variance of \$4.9 million related to adjustments to the reserve for uncertain tax positions, partially offset by the \$0.3 million reduction in the national gross receipts tax credit and the impact in 2013 of a net benefit of approximately \$0.5 million related to the increase in the deferred tax asset of profitable subsidiaries due to changes in statutory tax rates.

The income tax in the interim financial statements is calculated based on the income of the individual subsidiaries and the currently valid tax rates as a best possible estimate. As of September 30, 2014, the deferred tax asset, net of a valuation allowance of \$505.2 million, amounted to \$9.9 million compared to \$7.6 million as of December 31, 2013. The decrease in the valuation allowance to \$505.2 million, as of September 2014, from \$522.7 million as of December 31, 2013 was mainly due to the reversal of temporary differences primarily attributable to the reduction in the allowance for loan and lease losses during the first nine months of 2014.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on an assessment of the amount of the deferred tax asset that is “more likely than not” to be realized. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized.

In making such assessment, significant weight is given to evidence that can be objectively verified, including both positive and negative evidence. Consideration must be given to all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of the reversal of temporary differences and carry forwards, taxable income in carry back years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the maintenance of the valuation allowance was that the Corporation's banking subsidiary, FirstBank Puerto Rico, was in a three-year historical cumulative loss position as of September 30, 2014, mainly due to significant charges to the provision for loan and lease losses in prior years as a result of the economic downturn and the bulk sales of assets completed in 2013. As of September 30, 2014, the Corporation had a gross deferred tax asset of \$525.4 million, including \$373.6 million associated with NOLs. The Bank incurred all of the NOLs on or after 2009. As mentioned before, the Corporation maintained a valuation allowance of \$505.2 million as of September 30, 2014 against the deferred tax asset. As of September 30, 2014, management concluded that \$9.9 million of the deferred tax asset will be realized as it relates to profitable subsidiaries and to amounts that can be realized through future reversals of existing taxable temporary differences. To the extent the realization of a portion, or all, of the tax asset becomes "more likely than not" based on changes in circumstances (such as, improved earnings, changes in tax laws or other relevant changes), a reversal of that portion of the deferred tax asset valuation allowance will then be recorded.

The authoritative accounting guidance prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under this guidance, income tax benefits are recognized and measured based upon a two-step analysis: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized under this analysis and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit ("UTB").

As of September 30, 2014, the Corporation did not have UTBs recorded on its books. The years 2007 through 2009 were examined by the United States Internal Revenue Service ("IRS") and disputed issues were taken to administrative appeals during 2011. During the month of July 2014, the Corporation reached an agreement with the IRS Appeals office. Accordingly, the remaining UTB's recorded on the books in the amount of \$2.5 million was paid to settle the resulting tax liability. Such settlement did not have an impact on the effective tax rate.

The Corporation's liability for income taxes includes the estimate of interest not yet paid related to the settlement reached with the IRS to close the tax years 2007 through 2009 that were the subject of the IRS examination. The Corporation classifies all interest and penalties, if any, related to tax uncertainties as income tax expense. As of September 30, 2014, the Corporation's accrued interest that relates to the IRS examination amounted to \$1.4 million and there was no need to accrue for the payment of penalties. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the 2011 PR Code is 4 years; the statute of limitations for

Supplemental cash flow information is as follows:

Virgin Islands and U.S. income tax purposes are each three years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation's liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Virgin Islands and U.S income tax purposes, all tax years subsequent to 2010 remain open to examination. For Puerto Rico purposes, all tax years subsequent to 2009 remain open to examination. Tax year 2010 is currently under examination by the Puerto Rico Department of Treasury.

## FINANCIAL CONDITION AND OPERATING DATA ANALYSIS

## Assets

Total assets were \$12.6 billion, a decrease of \$13.6 million from December 31, 2013. The decrease was mainly related to a \$256.3 million decline in total loans, net of allowance, mainly reflecting large commercial and construction loans paid off, a decrease of \$101.2 million in the outstanding balances of credit facilities granted to government entities, primarily in Puerto Rico, and a \$47.4 million decrease in the OREO inventory balance driven by sales and valuation adjustments. These decreases were partially offset by higher cash balances. There were three large commercial loans paid off in Puerto Rico totaling approximately \$106.6 million and five impaired commercial and construction loans paid off in the United States totaling \$45.2 million.

<b>Loan Portfolio</b>					
The following table presents the composition of the Corporation's loan portfolio, including loans held for sale, as of the dates indicated:					
		<b>September 30,</b>		<b>December 31,</b>	
(In thousands)		<b>2014</b>		<b>2013</b>	
Residential mortgage loans	\$	2,819,648		\$	2,549,008
Commercial loans:					
Commercial mortgage loans		1,812,094			1,823,608
Construction loans		141,689			168,713
Commercial and Industrial loans (1)		2,515,384			2,788,250
Loans to a local financial institution collateralized by real estate mortgages (2)		-			240,072
Total commercial loans		4,469,167			5,020,643
Finance leases		236,115			245,323
Consumer loans		1,790,472			1,821,196
Total loans held for investment		9,315,402			9,636,170
Less:					
Allowance for loan and lease losses		(225,434)			(285,858)
Total loans held for investment, net	\$	9,089,968		\$	9,350,312
Loans held for sale		80,014			75,969
Total loans, net	\$	9,169,982		\$	9,426,281

Supplemental cash flow information is as follows:

(1)	As of September 30, 2014 and December 31, 2013, includes \$1.1 billion and \$1.2 billion, respectively, of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.
(2)	On May 30, 2014, FirstBank acquired from Doral mortgage loans, mainly residential mortgage loans, having an unpaid principal balance of \$241.7 million (estimated fair value at acquisition of \$226.0 million) in full satisfaction of secured borrowings with a book value of \$232.9 million owed by Doral to FirstBank.

As of September 30, 2014, the Corporation's total loans held for investment, net of allowance, decreased by \$260.3 million, when compared with the balance as of December 31, 2013. The decrease mainly reflects a \$101.2 million reduction in the outstanding balance of credit facilities granted to the government entities in Puerto Rico and the Virgin Islands, a \$54.6 million C&I loan paid in full in Puerto Rico before contractual maturity, a \$37.1 million adversely classified C&I loan in Puerto Rico that was paid-off in the first quarter of 2014, a \$16.2 million restructured commercial mortgage loan paid-in full in the United States, for which a recovery of previously charged-off amounts of \$4.1 million was recorded in the second quarter of 2014, and three adversely classified construction loans paid off in the United States totaling \$10.2 million.

As shown in the table above, the 2014 loans held for investment portfolio was comprised of commercial loans (48%), residential real estate loans (30%), and consumer and finance leases (22%). Of the total gross loan portfolio held for investment of \$9.3 billion as of September 30, 2014, approximately 83% has credit risk concentration in Puerto Rico, 10% in the United States (mainly in the state of Florida) and 7% in the Virgin Islands, as shown in the following table:

<b>As of September 30, 2014</b>	<b>Puerto Rico</b>		<b>Virgin Islands</b>		<b>United States</b>		<b>Total</b>	
	<b>(In thousands)</b>							
Residential mortgage loans	\$	2,139,435	\$	343,620	\$	336,593	\$	2,819,648
Commercial mortgage loans		1,445,044		71,888		295,162		1,812,094
Construction loans		92,734		25,631		23,324		141,689
Commercial and Industrial loans		2,131,996		109,943		273,445		2,515,384
Total commercial loans		3,669,774		207,462		591,931		4,469,167
Finance leases		236,115		-		-		236,115
Consumer loans		1,705,885		48,841		35,746		1,790,472
Total loans held for investment, gross	\$	7,751,209	\$	599,923	\$	964,270	\$	9,315,402
Loans held for sale		37,909		40,325		1,780		80,014
Total loans	\$	7,789,118	\$	640,248	\$	966,050	\$	9,395,416
<b>As of December 31, 2013</b>	<b>Puerto Rico</b>		<b>Virgin Islands</b>		<b>United States</b>		<b>Total</b>	
	<b>(In thousands)</b>							
Residential mortgage loans	\$	1,906,982	\$	348,816	\$	293,210	\$	2,549,008
Commercial mortgage loans		1,464,085		74,271		285,252		1,823,608
Construction loans		105,830		33,744		29,139		168,713
Commercial and Industrial loans		2,436,709		125,757		225,784		2,788,250
Loans to a local financial institution collateralized by real estate mortgages		240,072		-		-		240,072
Total commercial loans		4,246,696		233,772		540,175		5,020,643
Finance leases		245,323		-		-		245,323

Supplemental cash flow information is as follows:



Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Consumer loans		1,739,478		49,689		32,029		1,821,196
Total loans held for investment, gross	\$	8,138,479	\$	632,277	\$	865,414	\$	9,636,170
Loans held for sale		35,394		40,575		-		75,969
Total loans	\$	8,173,873	\$	672,852	\$	865,414	\$	9,712,139

## Loan Production

First BanCorp. relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage originations with wholesale servicing released mortgage loan purchases from mortgage bankers. The Corporation manages its construction and commercial loan originations through centralized units and most of its originations come from existing customers as well as through referrals and direct solicitations.

The following table details First BanCorp's loan production, including purchases, refinancings, renewals and draws from existing revolving and non-revolving commitments for the periods indicated:										
	Quarter Ended September 30,					Nine-Month Period Ended September 30,				
	2014		2013			2014		2013		
	(In thousands)									
Residential real estate	\$	168,931	\$	176,865	\$	481,019	\$	669,054		
C&I and commercial mortgage		495,108		448,189		1,356,175		1,144,844		
Construction		7,890		5,354		23,286		48,251		
Finance leases		18,443		26,770		59,190		79,037		
Consumer		216,432		262,920		711,656		797,470		
Total loan production	\$	906,804	\$	920,098	\$	2,631,326	\$	2,738,656		

The Corporation is experiencing continued loan demand and has continued its targeted origination strategies. During the third quarter and nine month period ended on September 30, 2014, total loan originations, including purchases, refinancings, renewals, and draws from existing revolving and non-revolving commitments, amounted to approximately \$906.8 million and \$2.6 billion, respectively, compared to \$920.1 million and \$2.7 billion, respectively, for the comparable periods in 2013.

Residential mortgage loan originations and purchases for the quarter and nine-month period ended September 30, 2014 amounted to \$168.9 million and \$481.0 million, respectively, compared to \$176.9 million and \$669.1 million, respectively, for the comparable periods in 2013, adversely affected by a decrease in refinancings and the current economic environment in Puerto Rico. Originations of auto loans (including finance leases) for the quarter and nine-month period ended September 30, 2014 amounted to \$99.8 million and \$365.6 million, respectively, compared to \$157.1 million and \$460.3 million, respectively, for the comparable periods in 2013. The decrease mainly resulted from decreased activity in new auto sales reflecting lower consumer confidence as a result of the prolonged economic

recession in Puerto Rico and demographic changes. Other personal loan originations for the quarter and nine-month period ended September 30, 2014 amounted to \$49.5 million and \$147.0 million, respectively, compared to \$49.1 million and \$154.2 million, respectively, for the comparable periods in 2013.

C&I loan originations (excluding government loans) for the quarter and nine-month period ended September 30, 2014 amounted to \$347.8 million and \$922.2 million, respectively, compared to \$285.9 million and \$806.6 million, respectively, for the comparable periods in 2013. The increase in the 2014 periods was mainly related to disbursements on existing credit facilities. Government loan originations for the quarter and nine-month period ended September 30, 2014 amounted to \$92.3 million and \$357.8 million, respectively, compared to \$159.7 million and \$327.6 million, respectively, for the comparable periods in 2013, also primarily reflecting disbursements on existing facilities.

The total loan originations statistics, based on regulatory guidance, include the utilization activity on the outstanding credit card portfolio for the quarter and nine-month period ended September 30, 2014 of approximately \$85.6 million and \$258.2 million, respectively, compared to \$83.5 million and \$261.9 million, respectively, for the comparable periods in 2013. The loan production statistics in the table above exclude the loans acquired from Doral in 2014.

#### *Residential Real Estate Loans*

As of September 30, 2014, the Corporation's residential real estate loan portfolio held for investment increased by \$270.6 million as compared to the balance as of December 31, 2013, mainly reflecting the impact of mortgage loans acquired from Doral in the second quarter of 2014 in full satisfaction of secured borrowings owed by such entity to FirstBank. Mortgage loans acquired from Doral include mortgage loans, primarily residential mortgage loans, with an unpaid principal balance of \$229.0 million, recorded at its estimated fair value at acquisition of \$213.7 million (carrying value of \$221.9 million as of September 30, 2014).

The remaining increase is mainly related to the origination of non-conforming loans in Puerto Rico during 2014 of approximately \$133 million, which are generally retained in our portfolio held for investment. These variances were partially offset by charge-offs, foreclosures and principal repayments.

The majority of the Corporation's outstanding balance of residential mortgage loans consists of fixed-rate, fully amortizing, full documentation loans. In accordance with the Corporation's underwriting guidelines, residential real estate loans are mostly fully documented loans, and the Corporation is not actively involved in the origination of negative amortization loans. Refer to the "Contractual Obligations and Commitments" discussion below for additional information about outstanding commitments to sell mortgage loans.

On October 2, 2014, FirstBank Puerto Rico, entered into a Mortgage Loan Purchase and Sale and Interim Servicing Agreement (the "Purchase Agreement") with Doral Bank, a wholly-owned subsidiary of Doral Financial Corporation. Pursuant to the Purchase Agreement, the Bank purchased on October 3, 2014 all rights, title and interests in certain performing residential mortgage loans with approximately \$192.6 million in outstanding unpaid principal balance in a cash transaction.

#### *Commercial and Construction Loans*

As of September 30, 2014, the Corporation's commercial and construction loan portfolio held for investment decreased by \$551.5 million, as compared to the balance of \$5.0 billion as of December 31, 2013. The reduction primarily reflects the effect of the Doral transaction explained above, the impact of certain large loans paid off during the first nine months of 2014 and charge-offs, including three large commercial loans paid off in Puerto Rico totaling approximately \$106.6 million, a \$16.2 million restructured commercial mortgage loan paid-in full in the United States, and \$10.2 million related to three adversely classified construction loans paid off in the United States. In addition, the outstanding balance of credit facilities granted to government entities in Puerto Rico and the Virgin Islands decreased by \$101.2 million.

These variances were partially offset by a \$57.6 million increase in the C&I and commercial mortgage portfolio of the United States. As part of the United States strategy, the Corporation has expanded its resources in the middle market and corporate areas in light of lending growth opportunities in this sector. The Corporation's commercial loans are primarily variable- and adjustable-rate loans.

As of September 30, 2014, the Corporation had \$364.3 million in credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$316.3 million was outstanding, compared to \$397.8

Supplemental cash flow information is as follows:

million outstanding as of December 31, 2013. In addition, the outstanding balance of facilities granted to the government of the Virgin Islands amounted to \$40.8 million as of September 30, 2014, compared to \$60.6 million as of December 31, 2013. Approximately \$201.4 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of the applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$24.8 million consists of loans to units of the central government, and approximately \$90.1 million consists of loans to public corporations that generally receive revenues from the rates they charge for services or products, such as electric power services, including a \$75.0 million credit extended to the Puerto Rico Electric Power Authority ("PREPA") for fuel purchases that have priority over senior bonds and other debt.

Major public corporations have varying degrees of independence from the central government and many receive appropriations or other payments from the Puerto Rico's government general fund. Debt issued by the central government can either carry the full faith, credit and taxing power of the Commonwealth of Puerto Rico or represent an obligation that is subject to annual budget appropriations. Furthermore, the Corporation had \$200.4 million outstanding as of September 30, 2014 in financing to the hotel industry in Puerto Rico guaranteed by the Puerto Rico Tourism Development Fund ("TDF"). The TDF is a subsidiary of the Government Development Bank ("GDB") that works with private-sector financial institutions to structure financings for new hospitality projects.

On June 28, 2014, the governor of Puerto Rico signed into law The Puerto Rico Public Corporations Debt Enforcement and Recovery Act (the "Recovery Act") to provide a legislative framework for certain public corporations that are experiencing severe financial stress to address their financial obstacles through an orderly, statutory process that allows them to handle their debts, while ensuring the continuity of essential services to citizens and infrastructure upgrades.

As of September 30, 2014, the Corporation had an exposure to public corporations covered by the Recovery Act amounting to \$86.1 million, including the \$75 million direct exposure to PREPA. In August 2014, PREPA entered into a forbearance agreement with a group of banks, including FirstBank, to extend further its maturing credit lines to March 31, 2015. As a result of the forbearance, this credit facility was classified as a Trouble Debt Restructuring ("TDR") loan during the third quarter of 2014. The loan was maintained in accrual status based on the estimated cash flows analysis performed on this noncollateral dependent loan, repayment prospects and compliance with contractual terms.

The Corporation has significantly reduced its exposure to construction loans and originations are mainly draws from existing commitments, including construction facilities tied to financings to the hotel industry guaranteed by TDF.

The decrease in the construction loan portfolio held for investment was driven by charge-offs, the aforementioned adversely classified loans paid off in Florida, and foreclosures.

The composition of the Corporation's construction loan portfolio held for investment as of September 30, 2014 by category and geographic location is as follows:

<b>As of September 30, 2014</b>										
	<b>Puerto Rico</b>			<b>Virgin Islands</b>			<b>United States</b>			<b>Total</b>
<b>(In thousands)</b>										
Loans for residential housing projects:										
Mid-rise (1)	\$	32,691		\$	4,187		\$	-	\$	36,878
Single-family, detached		15,525			-			11,153		26,678
Total for residential housing projects		48,216			4,187			11,153		63,556
Construction loans to individuals secured by residential properties		1,465			2,129			-		3,594
Loans for commercial projects		4,542			-			11,790		16,332
Bridge loans - commercial		-			13,256			-		13,256
Land loans - residential		23,670			6,185			381		30,236
Land loans - commercial		14,454			-			-		14,454
Total before net deferred fees and allowance for loan losses	\$	92,347		\$	25,757		\$	23,324	\$	141,428
Net deferred fees		387			(126)			-		261
Total construction loan portfolio, gross		92,734			25,631			23,324		141,689
Allowance for loan losses		(11,369)			(2,194)			(872)		(14,435)
Total construction loan portfolio, net	\$	81,365		\$	23,437		\$	22,452	\$	127,254
(1)	Mid-rise relates to buildings of up to 7 stories.									

The following table presents further information on the Corporation's construction portfolio as of and for the nine-month period ended September 30, 2014:

<b>(In thousands)</b>			
Total undisbursed funds under existing commitments	\$		37,784
Construction loans held for investment in non-accrual status	\$		30,111
Construction loans held for sale in non-accrual status	\$		47,802
Net charge offs - Construction loans	\$		6,164
Allowance for loan losses - Construction loans	\$		14,435

Supplemental cash flow information is as follows:

	Non-performing construction loans to total construction loans, including held for sale		41.12%	
	Allowance for loan losses - construction loans to total construction loans held for investments		10.19%	
	Net charge-offs (annualized) to total average construction loans		4.04%	



The following summarizes the construction loans for residential housing projects in Puerto Rico segregated by the estimated selling price of the units:				
		(In thousands)		
	Under \$300k	\$	12,049	
	Over \$600k (1)		36,167	
		\$	48,216	
(1)	Mainly composed of three residential housing projects in Puerto Rico.			

### *Consumer Loans and Finance Leases*

As of September 30, 2014, the Corporation's consumer loan and finance lease portfolio decreased by \$39.9 million, as compared to the portfolio balance as of December 31, 2013. The decrease was mainly the result of charge-offs and repayments that exceeded the volume of new originations. The auto and finance lease portfolio decreased by \$26.9 million reflecting an increased level of charge-offs experienced and the aforementioned reduced activity in new loan originations. The auto loan and finance lease portfolios in Puerto Rico amounted to \$1.1 billion and \$236.1 million, respectively, as of September 30, 2014. The remaining decrease of the consumer loan portfolio was primarily related to a \$9.5 million decline in the credit card loan balance.

### **Investment Activities**

As part of its liquidity, revenue diversification and interest rate risk strategies, First BanCorp. maintains an investment portfolio that is classified as available for sale. The Corporation's total available-for-sale investment securities portfolio as of September 30, 2014 amounted to \$2.0 billion, a slight decrease of \$1.1 million from December 31, 2013. During 2014, the Corporation completed purchases of approximately \$75 million of 10-15 year U.S. agency MBS (average yield of 2.46%) and approximately \$44 million of U.S. government and sponsored agencies debt securities (average yield of 1.72%).

Approximately 96% of the Corporation's available-for-sale securities portfolio is invested in U.S. Government and Agency debentures and fixed-rate U.S. government sponsored-agency MBS (mainly GNMA, FNMA and FHLMC fixed-rate securities). The Corporation's investment in equity securities classified as available for sale is minimal, approximately \$14 thousand, which consists of common stock of another financial institution in Puerto Rico.

As of September 30, 2014, the Corporation had outstanding \$61.1 million in obligations of the Puerto Rico government, mainly bonds of the GDB and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio, carried on its books at a fair value of \$46.4 million. During the first half of 2014, the Corporation sold \$4.6 million of Puerto Rico government agency bonds and received proceeds of \$10 million from matured Puerto Rico government securities. The fair value of the Puerto Rico government obligations held by the Corporation increased by approximately \$4.9 million during the first nine months of 2014.

On February 4, 2014, S&P downgraded the Commonwealth of Puerto Rico's debt to BB+, one level below investment grade. S&P also downgraded to levels below investment grade the credit rating of the GDB and other government entities. On February 7, 2014, Moody's downgraded the Commonwealth of Puerto Rico general obligation bonds to Ba2, two notches below investment grade. Moody's also downgraded to Ba2 the Public Building Authority Bonds, the Pension Funding Bonds, the GDB senior notes, the Municipal Finance Authority Bonds, the Puerto Rico Infrastructure Finance Authority Special Tax Revenue Bonds, the Convention Center District Authority Hotel Occupancy Tax Revenue Bonds, the Puerto Rico Highway and Transportation Authority Transportation Revenue Bonds, various ratings of the Puerto Rico Aqueduct and Sewer Authority, and the Puerto Rico Electric Power Authority. In addition, the Puerto Rico Sales Tax Financing Corporation's senior-lien bonds were downgraded by Moody's to Baa1 from A2, retaining investment grade status. Following the downgrades by S&P and Moody's, Fitch became the third agency to downgrade the Commonwealth of Puerto Rico debt to BB, two notches below investment grade. In July 2014, the Puerto Rico debt was downgraded further into speculative grade by these credit agencies after the enactment of the Recovery Act that provides a legislative framework for certain public corporations that are experiencing severe financial stress to address their financial obstacles through an orderly statutory process that allows them to handle their debts. S&P now rates Puerto Rico's general obligation bonds at BB, two notches below investment grade, Moody's at B2 a highly speculative rate, and Fitch at BB-, three notches below investment grade. The ultimate impact of the downgrades is unpredictable and may not be immediately apparent.

The issuers of Puerto Rico government and agencies bonds held by the Corporation have not defaulted, and the contractual payments on these securities have been made as scheduled. Despite the recent downgrades of Puerto Rico's debt, the risk profile has not changed materially taking into account progress on different elements such as increases in tax collections, reforms of the retirement systems, current negotiation on debt repayment acceleration clauses, and spending control efforts. On March 11, 2014, the Commonwealth of Puerto Rico sold \$3.5 billion in general obligation bonds at a yield of 8.73% to refinance short-term liabilities and to address liquidity needs, and, on July 1, 2014, the Governor of Puerto Rico signed a balanced budget for fiscal year 2015, the first balanced budget in more than a decade. Based on these facts and the Corporation's ability and intent to hold these securities until a recovery of the fair value occurs, the unrealized losses are considered temporary. The Corporation will continue to closely monitor Puerto Rico's political and economic status and evaluate the portfolio for any declines in value that could be considered other-than-temporary.

The following table presents the carrying value of investment securities at the indicated dates:					
	As of		As of		
	September 30,		December 31,		
	2014		2013		
	(In thousands)				
Money market investments	\$	16,957		\$	201,369
Investment securities available for sale, at fair value:					
U.S. Government and agencies obligations		306,027			256,994
Puerto Rico government obligations		46,389			51,330
Mortgage-backed securities		1,624,707			1,669,925
Equity securities		14			33
Total investment securities available for sale, at fair value		1,977,137			1,978,282
Other equity securities, including \$25.5 million and \$28.4 million of FHLB stock as of September 30, 2014 and December 31, 2013, respectively		25,752			28,691
Total money market investments and investment securities	\$	2,019,846		\$	2,208,342

Mortgage-backed securities at the indicated dates consist of:				
	<b>As of</b>		<b>As of</b>	
	<b>September 30,</b>		<b>December 31,</b>	
(In thousands)	<b>2014</b>		<b>2013</b>	
Available-for-sale:				
FHLMC certificates	\$	322,082	\$	322,187
GNMA certificates		397,203		445,008
FNMA certificates		869,306		861,783
Collateralized Mortgage Obligations issued or guaranteed by FHLMC		-		81
Other mortgage pass-through certificates		36,116		40,866
<b>Total mortgage-backed securities</b>	<b>\$</b>	<b>1,624,707</b>	<b>\$</b>	<b>1,669,925</b>

The carrying values of investment securities classified as available for sale as of September 30, 2014 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:				
	<b>Carrying</b>		<b>Weighted</b>	
(Dollars in thousands)	<b>Amount</b>		<b>Average Yield %</b>	
U.S. Government and agencies obligations				
Due within one year	\$	7,498		0.11
Due after one year through five years		169,937		1.18
Due after five years through ten years		128,592		1.52
		306,027		1.30
Puerto Rico Government obligations				
Due after one year through five years		29,810		4.49
Due after five years through ten years		886		5.20
Due after ten years		15,693		5.83
		46,389		4.95
<b>Total</b>		<b>352,416</b>		<b>1.89</b>
Mortgage-backed securities		1,624,707		2.67
Equity securities		14		-
<b>Total investment securities available for sale</b>	<b>\$</b>	<b>1,977,137</b>		<b>2.52</b>



Net interest income of future periods could be affected by prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration of the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by the Corporation's investment in callable securities. As of September 30, 2014, the Corporation has approximately \$81.3 million in debt securities (U.S. Agencies and Puerto Rico government securities) with embedded calls and with an average yield of 1.64%. Refer to the "Risk Management" section below for further analysis of the effects of changing interest rates on the Corporation's net interest income and of the interest rate risk management strategies followed by the Corporation. Also refer to Note 4 to the accompanying unaudited consolidated financial statements for additional information regarding the Corporation's investment portfolio.

## **RISK MANAGEMENT**

Risks are inherent in virtually all aspects of the Corporation's business activities and operations. Consequently, effective risk management is fundamental to the success of the Corporation. The primary goals of risk management are to ensure that the Corporation's risk-taking activities are consistent with the Corporation's objectives and risk tolerance, and that there is an appropriate balance between risk and reward in order to maximize stockholder value.

The Corporation has in place a risk management framework to monitor, evaluate and manage the principal risks assumed in conducting its activities. First BanCorp.'s business is subject to nine broad categories of risks: (1) liquidity risk, (2) interest rate risk, (3) market risk, (4) credit risk, (5) operational risk, (6) legal and compliance risk, (7) reputational risk, (8) model risk, and (9) capital risk. First BanCorp. has adopted policies and procedures designed to identify and manage risks to which the Corporation is exposed.

The Corporation's risk management policies are described below as well as in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp.'s 2013 Annual Report on Form 10-K.

### **Liquidity Risk and Capital Adequacy**

Liquidity is the ongoing ability to accommodate liability maturities and deposit withdrawals, fund asset growth and business operations, and meet contractual obligations through unconstrained access to funding at reasonable market rates. Liquidity management involves forecasting funding requirements and maintaining sufficient capacity to meet the needs for liquidity and accommodate fluctuations in asset and liability levels due to changes in the Corporation's

Supplemental cash flow information is as follows:

business operations or unanticipated events.

The Corporation manages liquidity at two levels. The first is the liquidity of the parent company, which is the holding company that owns the banking and non-banking subsidiaries. The second is the liquidity of the banking subsidiary. As of September 30, 2014, FirstBank could not pay any dividend to the parent company except upon receipt of prior approval by the New York FED and the Federal Reserve Board because of the Regulatory Agreements.

The Asset and Liability Committee of the Board of Directors is responsible for establishing the Corporation's liquidity policy as well as approving operating and contingency procedures, and monitoring liquidity on an ongoing basis. The Management's Investment and Asset Liability Committee ("MIALCO"), using measures of liquidity developed by management, which involve the use of several assumptions, reviews the Corporation's liquidity position on a monthly basis. The MIALCO oversees liquidity management, interest rate risk and other related matters.

The MIALCO, which reports to the Board of Directors' Asset and Liability Committee, is composed of senior management officers, including the Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, the Retail Financial Services Director, the Risk Manager of the Treasury and Investments Division, the Financial Analysis and Asset/Liability Director and the Treasurer. The Treasury and Investments Division is responsible for planning and executing the Corporation's funding activities and strategy, monitoring liquidity availability on a daily basis and reviewing liquidity measures on a weekly basis. The Treasury and Investments Accounting and Operations area of the Comptroller's Department is responsible for calculating the liquidity measurements used by the Treasury and Investment Division to review the Corporation's liquidity position on a monthly basis; the Financial Analysis and Asset/Liability Director estimates the liquidity gap for longer periods.

In order to ensure adequate liquidity through the full range of potential operating environments and market conditions, the Corporation conducts its liquidity management and business activities in a manner that will preserve and enhance funding stability, flexibility and diversity. Key components of this operating strategy include a strong focus on the continued development of customer-based funding, the maintenance of direct relationships with wholesale market funding providers, and the maintenance of the ability to liquidate certain assets when, and if, requirements warrant.

The Corporation develops and maintains contingency funding plans. These plans evaluate the Corporation's liquidity position under various operating circumstances and allow the Corporation to ensure that it will be able to operate through periods of stress when access to normal sources of funds is constrained. The plans project funding requirements during a potential period of stress, specify and quantify sources of liquidity, outline actions and procedures for effectively managing through a difficult period, and define roles and responsibilities. Under the contingency funding plan, the Corporation stresses the balance sheet and the liquidity position to critical levels that imply difficulties in getting new funds or even maintaining the current funding position of the Corporation and the Bank, thereby ensuring the ability of the Corporation and the Bank to honor their respective commitments, and establishing liquidity triggers monitored by the MIALCO in order to maintain the ordinary funding of the banking business. Four different scenarios are defined in the contingency funding plan: local market event, credit rating downgrade, an economic cycle downturn event, and a concentration event. They are reviewed and approved annually by the Board of Directors' Asset and Liability Committee.

The Corporation manages its liquidity in a proactive manner, and maintains a sound liquidity position. Multiple measures are utilized to monitor the Corporation's liquidity position, including core liquidity, basic liquidity, and time-based reserve measures. As of September 30, 2014, the estimated core liquidity reserve (which includes cash and free liquid assets) was \$1.6 billion or 13.0% of total assets, compared to \$1.35 billion or 10.7% of total assets as of December 31, 2013. The basic liquidity ratio (which adds available secured lines of credit to the core liquidity) was approximately 15.9% of total assets, compared to 14.35% of total assets as of December 31, 2013. As of September 30, 2014, the Corporation had \$371.8 million available for additional credit from the FHLB NY. Unpledged liquid securities as of September 30, 2014 mainly consisted of fixed-rate MBS and U.S. agency debentures amounting to approximately \$689.1 million. The Corporation does not rely on uncommitted inter-bank lines of credit (federal funds lines) to fund its operations and does not include them in the basic liquidity measure. The increased liquidity was primarily due to prepayments of MBS investments and certain large commercial loans paid-off deposited in cash balances with the Federal Reserve Bank generating interest income of 0.25%. The aforementioned acquisition of \$192.6 million of mortgage loans from Doral in October, 2014 was paid in cash. As of September 30, 2014, the

Supplemental cash flow information is as follows:



holding company had \$36.1 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of September 30, 2014 were approximately \$963.1 million. The Bank has \$3.1 billion in brokered CDs as of September 30, 2014, of which approximately \$1.8 billion mature over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 77% of the Bank's assets (or 53% excluding brokered CDs). The Corporation has continued to issue brokered CDs pursuant to temporary approvals received from the FDIC to renew or roll over brokered CDs up to certain amounts through March 31, 2015.

### *Sources of Funding*

The Corporation utilizes different sources of funding to help ensure that adequate levels of liquidity are available when needed. Diversification of funding sources is of great importance to protect the Corporation's liquidity from market disruptions. The principal sources of short-term funds are deposits, including brokered CDs, securities sold under agreements to repurchase, and lines of credit with the FHLB.

The Asset and Liability Committee of the Board of Directors reviews credit availability on a regular basis. The Corporation has also securitized and sold mortgage loans as a supplementary source of funding. Long-term funding has also been obtained through the issuance of notes and, to a lesser extent, long-term brokered CDs. The cost of these different alternatives, among other things, is taken into consideration.

The Corporation has continued reducing the amounts of brokered CDs. The reduction in brokered CDs is consistent with the requirements of the FDIC Order that preclude the issuance of brokered CDs without FDIC approval and require a plan to reduce the amount of brokered CDs. As of September 30, 2014, brokered CDs decreased \$78.2 million to \$3.1 billion from December 31, 2013. At the same time as the Corporation focuses on reducing its reliance on brokered deposits, it is seeking to add core deposits. During the first nine months of 2014, the Corporation increased non-brokered deposits, excluding government deposits, by \$138.6 million.

The Corporation continues to have the support of creditors, including counterparties to repurchase agreements, the FHLB, and other agents such as wholesale funding brokers. While liquidity is an ongoing challenge for all financial institutions, management believes that the Corporation's available borrowing capacity and efforts to grow retail deposits will be adequate to provide the necessary funding for the Corporation's business plans in the foreseeable future.

The Corporation's principal sources of funding are:

*Brokered CDs* – A large portion of the Corporation's funding has been retail brokered CDs issued by FirstBank. Total brokered CDs decreased by \$78.2 million to \$3.1 billion as of September 30, 2014. Because of the FDIC Order, FirstBank cannot replace maturing brokered CDs without the prior approval of the FDIC. Since the issuance of the FDIC Order, the FDIC has granted the Bank temporary waivers to enable it to continue accessing the brokered deposit market in specified amounts. The most recent waiver is effective through March 31, 2015. The Bank will request approvals for future periods. The Corporation used proceeds from repayments of loans and investments to pay down maturing borrowings, including brokered CDs. Also, the Corporation successfully implemented its core deposit growth strategy that resulted in an increase of \$138.6 million in non-brokered deposits, excluding government deposits, during the first nine months of 2014.

Supplemental cash flow information is as follows:

The average remaining term to maturity of the retail brokered CDs outstanding as of September 30, 2014 is approximately 1.1 years.

The use of brokered CDs has been particularly important for the growth of the Corporation. The Corporation encounters intense competition in attracting and retaining regular retail deposits in Puerto Rico. The brokered CDs market is very competitive and liquid, and has enabled the Corporation to obtain substantial amounts of funding in short periods of time. This strategy has enhanced the Corporation's liquidity position, since the brokered CDs are insured by the FDIC up to regulatory limits and can be obtained faster compared to regular retail deposits. During the first nine months of 2014, the Corporation issued \$1.2 billion in brokered CDs with an average cost of 0.78% to renew maturing brokered CDs. Management believes it will continue to obtain waivers from the restrictions on the issuance of brokered CDs under the FDIC Order to meet its obligations and execute its business plans.

The following table presents a maturity summary of brokered and retail CDs with denominations of \$100,000 or higher as of September 30, 2014:

			<b>Total</b>	
			<b>(In thousands)</b>	
	Three months or less	\$	772,368	
	Over three months to six months		607,539	
	Over six months to one year		1,339,298	
	Over one year		1,733,581	
	Total	\$	4,452,786	

Certificates of deposit in denominations of \$100,000 or higher include brokered CDs of \$3.1 billion issued to deposit brokers in the form of large (\$100,000 or more) certificates of deposit that are generally participated out by brokers in shares of less than \$100,000 and are therefore insured by the FDIC. Certificates of deposit with denominations of \$100,000 or higher also include \$2.4 million of deposits through the Certificate of Deposit Account Registry Service (CDARS).

*Government deposits* - As of September 30, 2014, the Corporation had \$250.9 million of Puerto Rico public sector deposits (\$228.2 million in transactional accounts and \$22.7 million in time deposits) compared to \$546.5 million as of December 31, 2013. Approximately 57% is from municipalities in Puerto Rico and 43% is from public corporations and the central government and agencies.

In 2014, Act 24-2014 was approved by the Puerto Rico Legislature, seeking to further strengthen the liquidity of the GDB and the GDB's oversight over public funds. Among other measures, Act 24-2014 grants the GDB the ability to exercise additional oversight of certain public funds deposited at private financial institutions and grants the GDB the legal authority, subject to an entity's ability to request waivers under certain specified circumstances, to require such public funds (other than funds of the Legislative Branch, the Judicial Branch, the University of Puerto Rico, governmental pension plans, municipalities and certain other independent agencies) to be deposited at the GDB, which is expected to result in a more efficient management of public resources in an effort to maximize liquidity and efficient use of public resources. The GDB expected to capture a portion of public funds deposited in private financial institutions. As anticipated, certain public corporations and agencies withdrew from FirstBank approximately \$341.6 million during the second quarter of 2014. The Corporation will continue to focus on transactional accounts and capture deposits from entities excluded from Act 24-2014.

In addition, as of September 30, 2014, the Corporation had \$217.8 million of government deposits in the Virgin Islands, compared to \$159.3 million as of December 31, 2013.

*Retail deposits* - The Corporation's deposit products also include regular savings accounts, demand deposit accounts, money market accounts and retail CDs. Total deposits, excluding brokered CDs and government deposits, increased

Supplemental cash flow information is as follows:

by \$138.6 million to \$6.2 billion as of September 30, 2014 from \$6.0 billion as of December 31, 2013, reflecting increases in core-deposit products such as savings and retail CDs primarily in Puerto Rico. Refer to Note 13 in the accompanying unaudited financial statements for further details.

Refer to the “Net Interest Income” discussion above for information about average balances of interest-bearing deposits, and the average interest rate paid on deposits for the quarters and nine-month periods ended September 30, 2014 and 2013.

*Securities sold under agreements to repurchase* - The Corporation’s investment portfolio is funded in part with repurchase agreements. The Corporation’s outstanding repurchase agreements amounted to \$900 million as of September 30, 2014 and December 31, 2013. One of the Corporation’s strategies has been the use of structured repurchase agreements and long-term repurchase agreements to reduce exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding costs at reasonable levels. All of the \$900 million of repurchase agreements outstanding as of September 30, 2014 consist of structured repurchase agreements. In addition to these repurchase agreements, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. Refer to Note 14 in the Corporation’s unaudited financial statements for the quarter and nine-month period ended September 30, 2014 for further details about repurchase agreements outstanding by counterparty and maturities.

In July, 2014, a \$100 million structured repurchase agreement that carried a floating rate converted to a fixed rate resulting in an increase of approximately \$0.4 million in interest expense for the third quarter of 2014. Another similar \$100 million structured repurchase agreement flipped to a fixed rate in October 2014 and is expected to result in a quarterly increase in interest expense of approximately \$0.5 million.

Under the Corporation's repurchase agreements, as is the case with derivative contracts, the Corporation is required to pledge cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines due to changes in interest rates, a liquidity crisis or any other factor, the Corporation is required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity.

Given the quality of the collateral pledged, the Corporation has not experienced significant margin calls from counterparties arising from credit-quality-related write-downs in valuations and, as of September 30, 2014, it had only \$0.2 million of cash equivalent instruments deposited in connection with collateralized interest rate swap agreements.

*Advances from the FHLB* – The Bank is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain qualifying mortgages and investments as collateral for advances taken. As of September 30, 2014 and December 31, 2013, the outstanding balance of FHLB advances was \$325.0 million and \$300.0 million, respectively. The Corporation entered into a 4-year FHLB advance of \$25 million with a rate of 1.79% in the third quarter of 2014. As of September 30, 2014, the Corporation had \$371.8 million available for additional credit on FHLB lines of credit.

Though currently not in use, other sources of short-term funding for the Corporation include commercial paper and federal funds purchased. Furthermore, in previous years, the Corporation entered into several financing transactions to diversify its funding sources, including the issuance of notes payable and junior subordinated debentures as part of its longer-term liquidity and capital management activities. No assurance can be given that these sources of liquidity will be available in the future and, if available, will be on acceptable terms.

In 2004, FBP Statutory Trust I, a statutory trust that is wholly owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors \$100 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase \$103.1 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors \$125 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase \$128.9 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

The cumulative trust preferred debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings. The variable rate trust preferred securities are fully and unconditionally guaranteed by the Corporation. The \$100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the \$125 million issued in September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust preferred securities). The trust preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current applicable rules and regulations. The Collins Amendment to the Dodd-Frank Act eliminates certain trust-preferred securities from Tier 1 Capital. Bank Holding Companies such as the Corporation must fully phase out these instruments of Tier I capital by January 1, 2016, however, they may remain in Tier 2 capital until the instruments are redeemed or mature. At September 30, 2014, the Corporation had \$225 million in trust preferred securities that are subject to the phase-out from Tier 1 Capital under the Basel 3 Final Rule.

With respect to the outstanding subordinated debentures, the Corporation elected to defer the interest payments that were due in quarterly periods since March 2012. The aggregate amount of payments deferred and accrued approximates \$20.1 million as of September 30, 2014. Under the indentures, we have the right, from time to time, and without causing an event of default, to defer payments of interest on the subordinated debentures by extending the interest payment period at any time and from time to time during the term of the subordinated debentures for up to twenty consecutive quarterly periods. Future interest payments are subject to Federal Reserve approval.

The Corporation's principal uses of funds are the origination of loans and the repayment of maturing deposits and borrowings. The Corporation has committed substantial resources to its mortgage-banking subsidiary, FirstMortgage Inc. As a result, the ratio of residential real estate loans to total loans has increased over time. Commensurate with the increase in its mortgage banking activities, the Corporation has also invested in technology and personnel to enhance the Corporation's secondary mortgage market capabilities.

The enhanced capabilities improve the Corporation's liquidity profile as they allow the Corporation to derive liquidity, if needed, from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid in large part because of the sale of mortgages through guarantee programs of the FHA, VA, HUD, FNMA and FHLMC. The Corporation obtained commitment authority to issue GNMA mortgage-backed securities from GNMA and, under this program; the Corporation completed the securitization of approximately \$144.6 million of FHA/VA mortgage loans into GNMA MBS during the first nine months of 2014. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

#### *Impact of Credit Ratings on Access to Liquidity*

The Corporation's liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation's current credit ratings and any further downgrades in credit ratings can hinder the Corporation's access to new forms of external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of unsecured derivatives that consider the Corporation's own credit risk as part of the valuation.

The Corporation does not have any outstanding debt or derivative agreements that would be affected by credit downgrades. Furthermore, given our non-reliance on corporate debt or other instruments directly linked in terms of pricing or volume to credit ratings, the liquidity of the Corporation so far has not been affected in any material way by downgrades. The Corporation's ability to access new non-deposit sources of funding, however, could be adversely affected by credit downgrades.

The Corporation's credit as a long-term issuer is currently rated B+ by S&P and B- by Fitch. At the FirstBank subsidiary level, long-term issuer ratings are currently B3 by Moody's, six notches below their definition of investment grade; B+ by S&P four notches below their definition of investment grade, and B- by Fitch, six notches below their definition of investment grade.

#### *Cash Flows*

Cash and cash equivalents were \$970.0 million as of September 30, 2014, an increase of \$314.3 million when compared to the balance as of December 31, 2013, while, as of September 30, 2013 the total balance of cash and cash equivalents amounted to \$824.4 million, a decrease of \$122.5 million from December 31, 2012. The following discussion highlights the major activities and transactions that affected the Corporation's cash flows during the first

Supplemental cash flow information is as follows:



nine months of 2014 and 2013.

### *Cash Flows from Operating Activities*

First BanCorp's operating assets and liabilities vary significantly in the normal course of business due to the amount and timing of cash flows. Management believes cash flows from operations, available cash balances and the Corporation's ability to generate cash through short- and long-term borrowings will be sufficient to fund the Corporation's operating liquidity needs.

For the first nine months of 2014 and 2013, net cash provided by operating activities was \$236.9 million and \$262.5 million, respectively. Net cash generated from operating activities was higher than reported net income largely as a result of adjustments for operating items such as the provision for loan and lease losses, depreciation and amortization, proceeds from sales of loans held for sale, and impairments.

### *Cash Flows from Investing Activities*

The Corporation's investing activities primarily relate to originating loans to be held for investment and purchasing, selling and repayments of available-for-sale investment securities. For the nine-month period ended September 30, 2014, net cash provided by investing activities was \$234.9 million, primarily reflecting principal repayments on loans held for investment and available-for-sale investment securities.

For the nine-month period ended September 30, 2013, net cash used by investing activities was \$313.2 million, primarily reflecting purchases of investment securities and loan originations in excess of loan principal repayments.

### *Cash Flows from Financing Activities*

The Corporation's financing activities primarily include the receipt of deposits and issuance of brokered CDs, the issuance and payments of long-term debt, the issuance of equity instruments and activities related to its short-term funding. During the nine-month period ended September 30, 2014, net cash used in financing activities was \$157.5 million, mainly due to the reduction in brokered CDs and deposit withdrawals by certain government entities and public corporations in Puerto Rico.

In the nine-month period ended September 30, 2013, net cash used by financing activities was \$71.8 million mainly due to repayments of maturing FHLB advances and brokered CDs.

### **Capital**

As of September 30, 2014, the Corporation's stockholders' equity was \$1.3 billion, an increase of \$108.3 million from December 31, 2013. The increase was mainly driven by the net income of \$61.5 million for the first nine months of 2014 and a \$44.4 million increase in other comprehensive income mainly attributable to an increase in the fair value of U.S. agency MBS and debt securities. As a result of the Written Agreement with the New York FED, currently neither First BanCorp., nor FirstBank, is permitted to pay dividends on capital securities without prior approval.

Although all of the regulatory capital ratios of the Bank exceeded the established "well capitalized" levels, as well as the minimum capital ratios required by the FDIC Order, as of September 30, 2014, FirstBank cannot be treated as a "well capitalized" institution since it is still subject to the FDIC Order. Set forth below are First BanCorp.'s, and FirstBank's regulatory capital ratios as of September 30, 2014 and December 31, 2013, based on existing established guidelines.



	Banking Subsidiary							
	First BanCorp	FirstBank	To be well capitalized	Consent Order Requirements over time				
<b>As of September 30, 2014</b>								
Total capital (Total capital to risk-weighted assets)	18.57%	18.21%	10.00%				12.00%	
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	17.30%	16.95%	6.00%				10.00%	
Leverage ratio	12.34%	12.10%	5.00%				8.00%	
<b>As of December 31, 2013</b>								
Total capital (Total capital to risk-weighted assets)	17.06%	16.67%	10.00%				12.00%	
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	15.78%	15.40%	6.00%				10.00%	
Leverage ratio	11.71%	11.44%	5.00%				8.00%	

The increase in capital ratios was primarily related to earnings recorded in the first nine months of 2014 and a reduction in risk-weighted assets mainly related to the decrease in commercial and construction loans.

In July 2013, U.S. banking regulators approved a revised regulatory capital framework for U.S. banking organizations (the “Basel 3 rules”) that is based on international regulatory capital requirements adopted by the Basel Committee on Banking Supervision over the past several years. The Basel 3 rules introduce new minimum capital ratios and capital conservation buffer requirements, change the composition of regulatory capital, require a number of new adjustments to and deductions from regulatory capital, and introduce a new “Standardized Approach” for the calculation of risk-weighted assets that will replace the risk-weighting requirements under the current U.S. regulatory capital rules. The new minimum regulatory capital requirements and the Standardized Approach for the calculation of risk-weighted assets will become effective for the Corporation and FirstBank on January 1, 2015. The capital conservation buffer requirements, and the regulatory capital adjustments and deductions under the Basel 3 rules will be phased-in over several years ending on December 31, 2018.

The Basel 3 rules introduce a new and separate ratio of Common Equity Tier 1 capital (“CET1”) to risk-weighted assets. CET1, a component of total Tier 1 capital, generally consists of common stock and related surplus, retained earnings, accumulated other comprehensive income (“AOCI”), and qualifying minority interests. In addition, the Basel 3 rules also will require the Corporation to maintain an additional CET1 capital conservation buffer of 2.5%. Thus, when the Basel 3 rules are fully phased in as of January 1, 2019, the Corporation will be required to maintain; (i) a minimum CET1 to risk-weighted assets ratio of at least 4.5%, plus the 2.5% “capital conservation buffer,” resulting in a required minimum CET1 ratio of at least 7% upon full implementation, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5% upon full implementation, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to

risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5% upon full implementation, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets. The phase-in of the capital conservation buffer will begin on January 1, 2016 with a first year requirement of 0.625% of additional CET1, which will be progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully-phased in 2.5% CET1 requirement on January 1, 2019.

In addition, the Basel 3 rules require a number of new deductions from and adjustments to CET1, including deductions from CET1 for mortgage servicing rights, and deferred tax assets dependent upon future taxable income. In the case of mortgage servicing assets and deferred tax assets, among others, these items would be required to be deducted to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under current regulatory capital requirements, the effect of AOCI is excluded for the purposes of calculating the required regulatory capital ratios. By comparison, under the Basel 3 rules, the effects of certain AOCI items are not excluded. Certain banking organizations, however, including the Corporation and FirstBank, will be allowed to make a one-time permanent election in early 2015 to continue to exclude AOCI items. The Corporation and FirstBank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the securities portfolio.

In addition, the Basel 3 rules will require that certain non-qualifying capital instruments, including cumulative preferred stock and Trust Preferred Securities (“TRuPs”), be excluded from Tier 1 capital. In general, banking organizations such as the Corporation and the Bank, that are not advanced approaches banks, must begin to phase out TRuPs from Tier 1 capital by January 1, 2015. The Corporation will be allowed to include 25% of the \$225 million outstanding qualifying TRuPs as Tier 1 capital in 2015 and the TRuPs must be fully phased out from Tier 1 capital by January 1, 2016. However, the Corporation’s TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

The Basel 3 rules also revise the “prompt corrective action” (“PCA”) regulations that apply to depository institutions, including FirstBank, pursuant to Section 38 of the Federal Deposit Insurance Act by (i) introducing a separate CET1 ratio requirement for each PCA capital category (other than critically undercapitalized) with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each PCA capital category with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that allows a bank with a composite supervisory rating of 1 to have a 3% leverage ratio and still be adequately capitalized and maintaining the minimum leverage ratio for well-capitalized status at 5%. The Basel 3 rules do not change the total risk-based capital requirement (10% for well-capitalized status) for any PCA capital category. The new PCA requirements become effective on January 1, 2015.

The Basel 3 rules separately impose a Standardized Approach for risk-weightings that expands the risk-weighting categories from the four major risk-weighting categories under the current regulatory capital rules (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets. In a number of cases, the Standardized Approach will result in higher risk weights for a variety of asset categories. Specific changes to the risk-weightings of assets under the current regulatory capital rules include, among other things: (i) applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans, (ii) assigning a 150% risk weight to exposures that are 90 days past due (other than qualifying residential mortgage exposures, which remain at an assigned risk-weighting of 100%), and (iii) establishing a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, in contrast to the 0% risk-weighting under the current rules.

The Corporation’s estimated pro-forma CET1 ratio, Tier 1 capital ratio, total capital ratio, and leverage ratio under the Basel 3 rules, giving effect as of September 30, 2014 to all the provisions that will be phased-in between January 1, 2015 and January 2019, was 13.7%, 14.1%, 17.8%, and 10.4%, respectively. These ratios would exceed the fully phased-in minimum capital ratios under Basel 3. Future estimates of the regulatory capital ratios under the Basel 3 rules may change over time as a result of further federal banking agency rulemaking or clarification.

The Corporation, as an institution with more than \$10 billion but less than \$50 billion of total consolidated assets, is subject to certain requirements established by the Dodd-Frank Act, including those related to capital stress testing. The Dodd-Frank Act stress testing requirements are implemented through the Federal Reserve’s Comprehensive Capital Analysis and Review program (CCAR), and by the Office of the Comptroller of the Currency (OCC) through their Dodd-Frank Act Stress Testing program (DFAST). Consistent with requirements of these programs, the

Supplemental cash flow information is as follows:

Corporation's first annual company-run stress test should be submitted to regulators no later than March 31, 2015. Public disclosure of the results for the severely adverse economic scenario is expected to be made during the second quarter of 2015 on the Corporation's website.

The tangible common equity ratio and tangible book value per common share are non-GAAP measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill, core deposit intangibles, and purchased credit card relationship intangible assets. Tangible assets are total assets less goodwill, core deposit intangibles, and purchased credit card relationship intangible assets. Refer to "Basis of Presentation" section below for additional information.

The following table is a reconciliation of the Corporation's tangible common equity and tangible assets for the periods ended September 30, 2014 and December 31, 2013, respectively:

	September 30,		December 31,	
(In thousands, except ratios and per share information)	2014		2013	
Total equity - GAAP	\$	1,324,157	\$	1,215,858
Preferred equity		(36,104)		(63,047)
Goodwill		(28,098)		(28,098)
Purchased credit card relationship		(17,235)		(19,787)
Core deposit intangible		(5,810)		(6,981)
<b>Tangible common equity</b>	<b>\$</b>	<b>1,236,910</b>	<b>\$</b>	<b>1,097,945</b>
Total assets - GAAP	\$	12,643,280	\$	12,656,925
Goodwill		(28,098)		(28,098)
Purchased credit card relationship		(17,235)		(19,787)
Core deposit intangible		(5,810)		(6,981)
<b>Tangible assets</b>	<b>\$</b>	<b>12,592,137</b>	<b>\$</b>	<b>12,602,059</b>
<b>Common shares outstanding</b>		<b>212,978</b>		<b>207,069</b>
<b>Tangible common equity ratio</b>		<b>9.82%</b>		<b>8.71%</b>
<b>Tangible book value per common share</b>	<b>\$</b>	<b>5.81</b>	<b>\$</b>	<b>5.30</b>

The Tier 1 common equity to risk-weighted assets ratio is calculated by dividing (a) Tier 1 capital less capital other than common stock, including qualifying perpetual preferred stock and qualifying trust preferred securities, by (b) risk-weighted assets, which assets are calculated in accordance with applicable bank regulatory requirements. The Tier 1 common equity ratio is not required by GAAP. Management is currently monitoring this ratio, along with the other ratios discussed above, in evaluating the Corporation's capital levels and believes that, at this time, the ratio may continue to be of interest to investors.



The following table reconciles stockholders' equity (GAAP) to Tier 1 common equity based on current applicable bank regulatory requirements (known as "Basel I"):					
		September 30,		December 31,	
(In thousands)		2014		2013	
Total equity - GAAP	\$	1,324,157		\$	1,215,858
Qualifying preferred stock		(36,104)			(63,047)
Unrealized loss on available-for-sale securities (1)		34,301			78,734
Goodwill		(28,098)			(28,098)
Core deposit intangible		(5,810)			(6,981)
Other disallowed assets		(23)			(23)
<b>Tier 1 common equity</b>	<b>\$</b>	<b>1,288,423</b>		<b>\$</b>	<b>1,196,443</b>
<b>Total risk-weighted assets</b>	<b>\$</b>	<b>8,954,477</b>		<b>\$</b>	<b>9,405,798</b>
<b>Tier 1 common equity to risk-weighted assets ratio</b>		<b>14.39%</b>			<b>12.72%</b>
(1)	Tier 1 capital excludes net unrealized gains (losses) on available-for-sale debt securities and net unrealized gains on available-for-sale equity securities with readily determinable fair values, in accordance with regulatory risk-based capital guidelines. In arriving at Tier 1 capital, institutions are required to deduct net unrealized losses on available-for-sale equity securities with readily determinable fair values, net of tax.				

In the first nine months of 2014, the Corporation issued an aggregate of 4,597,121 shares of its common stock in exchange for an aggregate of 1,077,726 shares of the Corporation's Series A through E Preferred Stock, having an aggregate liquidation value of \$26.9 million. The shares of common stock were issued to holders of the Series A through E Preferred Stock in reliance upon the exemption set forth in Section 3(a)(9) of the Securities Act of 1933, as amended, for securities exchanged by an issuer with existing security holders where no commission or other remuneration is paid or given directly or indirectly by the issuer for soliciting such exchange.

On September 9, 2014, the U.S. Department of Treasury announced that it would continue to wind down its investment in First BanCorp. by selling additional shares of common stock through its first pre-defined written trading plan. As of the announcement date, the U.S. Treasury held 19,680,441 shares, or approximately 9.2% of First BanCorp.'s common stock. Back in 2013, the U.S. Treasury sold 13,261,356 shares of First BanCorp.'s common stock at \$6.75 per share in a registered offering.

## **Off -Balance Sheet Arrangements**

In the ordinary course of business, the Corporation engages in financial transactions that are not recorded on the balance sheet, or may be recorded on the balance sheet in amounts that are different from the full contract or notional amount of the transaction. These transactions are designed to (1) meet the financial needs of customers, (2) manage the Corporation's credit, market or liquidity risks, (3) diversify the Corporation's funding sources and (4) optimize capital.

As a provider of financial services, the Corporation routinely enters into commitments with off-balance sheet risk to meet the financial needs of its customers. These financial instruments may include loan commitments and standby letters of credit. These commitments are subject to the same credit policies and approval process used for on-balance sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. As of September 30, 2014, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$1.1 billion (including \$648.4 million pertaining to credit card loans) and \$47.0 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation does not enter into interest rate lock agreements with prospective borrowers in connection with mortgage banking activities.

<b>Contractual Obligations, Commitments and Contingencies</b>										
The following table presents a detail of the maturities of the Corporation's contractual obligations and commitments, which consist of CDs, long-term contractual debt obligations, commitments to sell mortgage loans and commitments to extend credit:										
<b>Contractual Obligations and Commitments</b>										
<b>As of September 30, 2014</b>										
	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>After 5 years</b>					
<b>(In thousands)</b>										
Contractual obligations:										
Certificates of deposit	\$ 5,276,850	\$ 3,258,400	\$ 1,743,740	\$ 238,475	\$ 36,235					
Securities sold under agreements to repurchase	900,000	-	600,000	300,000	-					
Advances from FHLB	325,000	-	300,000	25,000	-					
Other borrowings	231,959	-	-	-	231,959					
<b>Total contractual obligations</b>	<b>\$ 6,733,809</b>	<b>\$ 3,258,400</b>	<b>\$ 2,643,740</b>	<b>\$ 563,475</b>	<b>\$ 268,194</b>					
Commitments to sell mortgage loans										
	\$ 82,021	\$ 82,021								
Standby letters of credit										
	\$ 9,956	\$ 9,956								
Commitments to extend credit:										
Lines of credit	\$ 1,094,250	\$ 1,094,250								
Letters of credit	37,021	37,021								
Commitments to originate loans	42,723	42,723								
<b>Total commercial commitments</b>	<b>\$ 1,173,994</b>	<b>\$ 1,173,994</b>								

The Corporation has obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under other commitments to sell mortgage loans at fair value and to extend credit. 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. Other contractual obligations result mainly from contracts for the rental and maintenance of equipment. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. There have been no significant or unexpected draws on existing commitments. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause.

### ***Interest Rate Risk Management***

First BanCorp. manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income and to maintain stability of profitability under varying interest rate scenarios. The MIALCO oversees interest rate risk, and MIALCO meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, securities market values, recent or proposed changes to the investment portfolio, alternative funding sources and related costs, hedging and the possible purchase of derivatives such as swaps and caps, and any tax or regulatory issues which may be pertinent to these areas. The MIALCO approves funding decisions in light of the Corporation's overall strategies and objectives.

On a quarterly basis, the Corporation performs a consolidated net interest income simulation analysis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one-to-five-year time horizon, assuming upward and downward yield curve shifts. The rate scenarios considered in these simulations reflect gradual upward and downward interest rate movements of 200 basis points, during a twelve-month period. Simulations are carried out in two ways:

- (1) Using a static balance sheet, as the Corporation had on the simulation date, and
- (2) Using a dynamic balance sheet based on recent patterns and current strategies.

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing structure and their corresponding interest yields and costs. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and costs, the possible exercise of options, changes in prepayment rates, deposit decay and other factors which may be important in projecting net interest income.

The Corporation uses a simulation model to project future movements in the Corporation's balance sheet and income statement. The starting point of the projections generally corresponds to the actual values on the balance sheet on the date of the simulations.

These simulations are highly complex, and are based on many assumptions that are intended to reflect the general behavior of the balance sheet components over the period in question. It is unlikely that actual events will match these assumptions in all cases. For this reason, the results of these forward-looking computations are only approximations of the true sensitivity of net interest income to changes in market interest rates. Several benchmark and market rate curves were used in the modeling process, primarily the LIBOR/SWAP curve, Prime, Treasury, FHLB rates, brokered CDs rates, repurchase agreement rates and the mortgage commitment rate of 30 years.

The 12-month net interest income is forecasted assuming the September 30, 2014 interest rate curves remain constant. Then net interest income is estimated under rising and falling rate scenarios.

For rising rate scenarios, a gradual (ramp) parallel upward shift of the yield curves is assumed during the first twelve months (the “+200 ramp” scenario). Conversely, for the falling rate scenarios, a gradual (ramp) parallel downward shift of the yield curves is assumed during the first twelve months (the “-200 ramp” scenario). However, given the current low levels of interest rates, a full downward shift of 200 basis points would represent an unrealistic scenario. Therefore, under the falling rate scenario, rates move downward up to 200 basis points, but without reaching zero. The resulting scenario shows interest rates close to zero in most cases, reflecting a flattening yield curve instead of a parallel downward scenario.

The Libor/Swap curve for September 30, 2014, as compared to December 2013, remained almost flat in the short-term horizon, between one to twelve months, with a decrease of 1 basis point, while market rates increased by 30 basis points in the medium term, that is, between 2 to 5 years. In the long term, that is over a 5 year-term horizon, market rates decreased by 40 basis points. The Treasury curve decreased by 3 basis points in the short term and increased by 10 basis points in the medium term horizon as compared to December 31, 2013 end of month levels. The long term horizon decreased by almost 57 basis points as compared to December 2013 end of month levels.

The following table presents the results of the simulations as of September 30, 2014 and December 31, 2013. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives:													
September 30, 2014							December 31, 2013						
Net Interest Income Risk							Net Interest Income Risk						
(Projected for the next 12 months)							(Projected for the next 12 months)						
Static Simulation				Growing Balance Sheet			Static Simulation				Growing Balance Sheet		
(Dollars in millions)	Change	% Change		Change	% Change		Change	% Change		Change	% Change		
+ 200 bps ramp	\$ 15.3	3.04	%	\$ 13.4	2.63	%	\$ 14.6	2.76	%	\$ 12.1	2.23	%	
- 200 bps ramp	\$ (8.0)	(1.60)	%	\$ (7.4)	(1.45)	%	\$ (10.6)	(2.00)	%	\$ (10.8)	(1.99)	%	

The Corporation continues to manage its balance sheet structure to control the overall interest rate risk. Among the major drivers behind the slight shift in interest income sensitivity to interest rate shifts are the increase of \$314.3 million in cash and cash equivalents and the purchase of \$75 million of 10-15 year U.S. agency MBS with an average yield of 2.46% and \$44 million of U.S agency sponsored entities debt securities with an average yield of 1.72%. The liabilities side was affected mainly by the net decrease of \$237.2 million in government deposits, the reduction of \$78.2 million in brokered CDs, and the \$25 million increase in FHLB advances with a rate of 1.79%.

Taking into consideration the above-mentioned facts for modeling purposes, the net interest income for the next twelve months under a non-static or growing balance sheet scenario, is estimated to increase by \$13.4 million in the rising rates scenario when compared against the Corporation's flat or unchanged interest rate forecast scenario. Under the falling rate, non-static scenario, the net interest income is estimated to decrease by \$7.4 million.

#### *Derivatives*

First BanCorp. uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management's control.

The following summarizes major strategies, including derivative activities, used by the Corporation in managing interest rate risk:

*Interest rate cap agreements* - Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements for protection from rising interest rates.

*Interest rate swaps* - Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of September 30, 2014, most of the interest rate swaps outstanding are used for protection against rising interest rates. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being economically hedged.

*Forward Contracts* - Forward contracts are sales of TBA MBS investments that will settle over the standard delivery date and do not qualify as "regular way" security trades. Regular-way security trades are contracts that have no net settlement provision and no market mechanism to facilitate net settlement and provide for delivery of a security within

Supplemental cash flow information is as follows:

the time generally established by regulations or conventions in the market place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked to market. These securities are used to hedge the FHA/VA residential mortgage loan securitizations of the mortgage-banking operations. Unrealized gains (losses) are recognized as part of mortgage banking activities in the consolidated statement of income (loss).

For detailed information regarding the volume of derivative activities (e.g. notional amounts), location and fair values of derivative instruments in the Statement of Financial Condition and the amount of gains and losses reported in the Statement of Income (Loss), refer to Note 9 in the accompanying unaudited consolidated financial statements.



The following tables summarize the fair value changes in the Corporation's derivatives as well as the sources of the fair values:

	Asset Derivatives		Liability Derivatives	
	Nine-Month Period Ended		Nine-Month Period Ended	
(In thousands)	September 30, 2014		September 30, 2014	
Fair value of contracts outstanding at the beginning of the period	\$	394	\$	4,023
Fair value of new contracts entered into during the period		-		-
Changes in fair value during the period		(292)		(1,112)
Fair value of contracts outstanding as of September 30, 2014	\$	102	\$	2,911

Sources of Fair Value		Payment Due by Period							Total Fair Value
		Maturity Less Than One Year	Maturity 1-3 Years	Maturity 3-5 Years	Maturity in Excess of 5 Years				
<i>(In thousands)</i>									
<b>As of September 30, 2014</b>									
Pricing from observable market inputs - Asset Derivatives		\$ 84	\$ 18	\$ -	\$ -			\$ 102	
Pricing from observable market inputs - Liability Derivatives		(83)	(2,828)	-	-			(2,911)	
		\$ 1	\$ (2,810)	\$ -	\$ -			\$ (2,809)	

Derivative instruments, such as interest rate swaps, are subject to market risk. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the level of interest rates, as well as the expectations for rates in the future.

As of September 30, 2014 and December 31, 2013, all of the derivative instruments held by the Corporation were considered economic undesignated hedges.

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of derivative contracts based on changes in interest rates. The credit risk of derivatives arises from the potential of default from the counterparty. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. Master netting agreements incorporate rights of set-off that provide for the net settlement of contracts with the same counterparty in the event of default. All of the Corporation's interest rate swaps are supported by securities collateral agreements, which allow the delivery of securities to and from the counterparties depending on the fair value of the instruments, to minimize credit risk.

Refer to Note 19 of the accompanying unaudited consolidated financial statements for additional information regarding the fair value determination of derivative instruments.

Set forth below is a detailed analysis of the Corporation's credit exposure by counterparty with respect to derivative instruments outstanding as of September 30, 2014 and December 31, 2013.												
(In thousands)												
As of September 30, 2014												
Counterparty	Rating <sup>(1)</sup>	Notional	Total Exposure at Fair Value <sup>(2)</sup>	Negative Fair Value	Total Fair Value	Accrued interest receivable (payable)						
Interest rate swaps with rated counterparties:												
JP Morgan	A	\$ 25,306	\$ -	\$ (2,810)	\$ (2,810)	\$ (115)						
Other derivatives (3):												
Interest rate swaps		5,440	67	(67)	-	(11)						
Written and purchase interest rate caps		74,906	18	(18)	-	-						
Forward contracts		22,000	17	(16)	1	-						
<b>Total</b>		<b>\$ 127,652</b>	<b>\$ 102</b>	<b>\$ (2,911)</b>	<b>\$ (2,809)</b>	<b>\$ (126)</b>						

(In thousands)												
As of December 31, 2013												
Counterparty	Rating <sup>(1)</sup>	Notional	Total Exposure at Fair Value <sup>(2)</sup>	Negative Fair Value	Total Fair Value	Accrued Interest receivable (payable)						
Interest rate swaps with rated counterparties:												
JP Morgan	A	\$ 25,640	\$ -	\$ (3,802)	\$ (3,802)	\$ (121)						
Other derivatives (3):												
Interest rate swaps		5,440	162	(163)	(1)	(11)						
Written and purchase interest rate caps		76,782	58	(58)	-	-						
Forward contracts		25,000	174	-	174	-						
<b>Total</b>		<b>\$ 132,862</b>	<b>\$ 394</b>	<b>\$ (4,023)</b>	<b>\$ (3,629)</b>	<b>\$ (132)</b>						

Supplemental cash flow information is as follows:



### *Credit Risk Management*

First BanCorp. is subject to credit risk mainly with respect to its portfolio of loans receivable and off-balance sheet instruments, mainly derivatives and loan commitments. Loans receivable represents loans that First BanCorp. holds for investment and, therefore, First BanCorp. is at risk for the term of the loan. Loan commitments represent commitments to extend credit, subject to specific conditions, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as for loans. Refer to “Contractual Obligations and Commitments” above for further details. The credit risk of derivatives arises from the potential of the counterparty’s default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation’s derivative credit risk exposure, refer to “Interest Rate Risk Management” above. The Corporation manages its credit risk through its credit policy, underwriting, independent loan review and quality control procedures, statistical analysis, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, personnel performing structured loan workout functions are responsible for mitigating defaults and minimizing losses upon default within each region and for each business segment. In the case of the C&I, commercial mortgage and construction loan portfolios, the Special Asset Group (“SAG”) focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary.

The Corporation may also have risk of default in the securities portfolio. The securities held by the Corporation are principally fixed-rate U.S. agency mortgage-backed securities and U.S. Treasury and agency securities. Thus, a substantial portion of these instruments is backed by mortgages, a guarantee of a U.S. government-sponsored entity or the full faith and credit of the U.S. government.

Management, consisting of the Corporation’s Commercial Credit Risk Officer, Retail Credit Risk Officer, Chief Lending Officer and other senior executives, has the primary responsibility for setting strategies to achieve the Corporation’s credit risk goals and objectives. These goals and objectives are documented in the Corporation’s Credit Policy.

*Allowance for Loan and Lease Losses and Non-performing Assets*

*Allowance for Loan and Lease Losses*

The allowance for loan and lease losses represents the estimate of the level of reserves appropriate to absorb inherent credit losses. The amount of the allowance was determined by empirical analysis and judgments regarding the quality of each individual loan portfolio. All known relevant internal and external factors that affected loan collectability were considered, including analyses of historical charge-off experience, migration patterns, changes in economic conditions, and changes in loan collateral values. For example, factors affecting the economies of Puerto Rico, Florida (USA), the US Virgin Islands and the British Virgin Islands may contribute to delinquencies and defaults above the Corporation's historical loan and lease losses. Such factors are subject to regular review and may change to reflect updated performance trends and expectations, particularly in times of severe stress. The process includes judgments and quantitative elements that may be subject to significant change. There is no certainty that the allowance will be adequate over time to cover credit losses in the portfolio because of continued adverse changes in the economy, market conditions, or events adversely affecting specific customers, industries or markets. To the extent actual outcomes differ from our estimates, the credit quality of our customer base materially decreases, the risk profile of a market, industry, or group of customers changes materially, or the allowance is determined to not be adequate, additional provisions for credit losses could be required, which could adversely affect our business, financial condition, liquidity, capital, and results of operations in future periods.

The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and probable losses believed to be inherent in the loan portfolio that have not been specifically identified. Internal risk ratings are assigned to each business loan at the time of approval and are subject to subsequent periodic reviews by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation's continued evaluation of its asset quality.

During the second quarter of 2014, the Corporation made certain enhancements to the general allowance estimation process for commercial loans which mainly consisted of the following:

**Utilization of longer historical loss periods to better reflect the level of incurred losses in the portfolio.**

Historical charge-off rates are calculated by the Corporation on a quarterly basis by tracking cumulative charge-offs experienced over a two-year loss period on loans according to their internal risk rating (referred to as "base rate" for the quarter). Prior to the second quarter enhancements, the Corporation would use the base rate of the current quarter or the average of the last 4 quarters, if greater. During second quarter of 2014, the Corporation eliminated the use of the "greater of" approach and adopted the utilization of the base rate average of the last 8 quarters. This change captures a longer historical period that would help mitigate period to period volatility in the loss rates.

**Enhancements of the environmental factors adjustment.** Prior to the second quarter of 2014 enhancements, these adjustments were applied in the form of basis points additions to the loss ratio based on changes in credit and economic indicators observed in the most recent periods. Beginning in the second quarter of 2014, the resulting factor derived from a set of risk-based ratings and weights assigned to credit and economic indicators activity over a reasonable period is now applied to a developed expected range of historical losses, in order to adjust the base rates. These enhancements result in a framework that can be applied more consistently, by having a more granular analysis that better captures trends in economic conditions and the impact in the Corporation's portfolio.

In addition, the calculation of loss rates for asset classifications with limited or zero loss history was improved to consider these loans' migration experience.

The Corporation maintained a parallel computation of the general reserve for commercial loans. The enhancements to the general allowance estimation process resulted in a net decrease to the allowance for loan losses of \$4.8 million as of the implementation date of May 31, 2014.

In the third quarter of 2014, similar enhancements to the environmental factors adjustment framework were applied to the consumer loans portfolio. The framework was defined for secured and unsecured loans to consider the specific behaviors separately. With respect to the historical charge-off rates, during the third quarter of 2014, the Corporation adopted the utilization of the base rate calculated as the average of net charge-off ratio for the 12 month period preceding the most recent four quarters. Previously, the base rate was calculated as the average of the last two years annual net charge-off ratio. The effect of these enhancements on the allowance for consumer loans was immaterial as of the implementation date of August 31, 2014.

The ratio of allowance for loan losses to total loans held for investment decreased to 2.42% as of September 30, 2014 from 2.97% as of December 31, 2013, primarily due to charge-offs on certain collateral-dependent commercial loans that did not require additional reserves, updated appraisals, and reserve releases on non-performing and adversely classified construction and commercial loans paid off. In addition, the reserve required for the non-impaired mortgage loans acquired from Doral was lower than the portion of the general reserve of commercial loans related to the secured borrowings, and the purchased credit impaired loans acquired from Doral, with an estimated fair value at acquisition of \$102.8 million, required no allowance as of September 30, 2014. The allowance to total loans for each of the Corporation's categories of loans changed as follows: the allowance to total loans for the C&I portfolio decreased from 2.82% as of December 31, 2013 to 2.52% at September 30, 2014; the allowance to total loans for the commercial mortgage portfolio decreased from 4.01% at December 31, 2013 to 2.89% at September 30, 2014; the allowance to total loans for the construction loans portfolio decreased from 21.23% at December 31, 2013 to 10.19% at September 30, 2014; the allowance to total loans for the residential mortgage portfolio decreased from 1.30% at December 31, 2013 to 1.06% at September 30, 2014; and the allowance to total consumer and finance leases increased from 2.83% as of December 31, 2013 to 3.22% as of September 30, 2014 primarily due to higher loss rates impacted by charge-offs trends and general economic conditions in Puerto Rico.

Substantially all of the Corporation's loan portfolio is located within the boundaries of the U.S. economy. Whether the collateral is located in Puerto Rico, the U.S. and British Virgin Islands or the U.S. mainland (mainly in the state of Florida), the performance of the Corporation's loan portfolio and the value of the collateral supporting the transactions are dependent upon the performance of and conditions within each specific area's real estate market. The real estate market in Puerto Rico has experienced readjustments in value over the last few years driven by the loss of income due to higher unemployment, reduced demand and general adverse economic conditions. The Corporation sets adequate loan-to-value ratios upon original approval following its regulatory and credit policy standards. The real estate market for the U.S. Virgin Islands has declined mostly due to the effect of the slow stateside economy and due to the increase in inventory after the closing in 2012 of the Hovensa refinery in St Croix. In Florida, we operate mostly in Miami, where home prices have improved, mostly driven by a higher demand from foreign investors, and a decrease in distressed property sales. As discussed under the "Provision for Loan and Lease Losses" section above, the Corporation has experienced in 2014 a significant increase in recoveries of amounts previously charged-off in the Florida region related to commercial mortgage and construction portfolios.

As shown in the following table, the allowance for loan and lease losses amounted to \$225.4 million as of September 30, 2014, or 2.42% of total loans, compared with \$285.9 million, or 2.97% of total loans, as of December 31, 2013. Refer to the "Provision for Loan and Lease Losses" above for additional information.





	Quarter Ended						Nine-Month Period Ended					
	September 30,						September 30,					
(Dollars in thousands)	2014			2013			2014			2013		
Allowance for loan and lease losses, beginning of period	\$	241,177		\$	301,047		\$	285,858		\$	435,414	
Provision (release) for loan and lease losses:												
Residential Mortgage (1)		5,885			4,663			13,570			86,888	
Commercial Mortgage (2)		2,721			(59)			(6,938)			49,551	
Commercial and Industrial (3) (4)		3,017			1,090			35,444			32,216	
Construction (5)		(3,652)			1,304			(15,215)			15,315	
Consumer and Finance Leases		19,028			15,197			58,797			36,812	
Provision for loan and lease losses (6)		26,999			22,195			85,658			220,782	
Charge-offs												
Residential Mortgage (7)		(5,970)			(8,698)			(17,379)			(124,323)	
Commercial Mortgage (8)		(2,823)			(5,944)			(22,056)			(65,271)	
Commercial and Industrial (9) (10)		(17,605)			(7,419)			(59,516)			(99,527)	
Construction (11)		(7,691)			(1,824)			(11,322)			(42,854)	
Consumer and Finance Leases		(19,848)			(15,559)			(56,425)			(46,673)	
		(53,937)			(39,444)			(166,698)	(12)		(378,648)	(12)
Recoveries:												
Residential Mortgage		236			241			605			868	
Commercial Mortgage		3,939			26			8,271			64	
Commercial and Industrial		1,174			1,701			2,253			3,460	
Construction		4,486			1,895			5,158			2,042	
Consumer and Finance Leases		1,360			1,718			4,329			5,397	
		11,195			5,581			20,616			11,831	
Net Charge-Offs		(42,742)			(33,863)			(146,082)			(366,817)	

Supplemental cash flow information is as follows:

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Allowance for loan and lease losses, end of period	\$	225,434			\$	289,379			\$	225,434			\$	289,379		
Allowance for loan and lease losses to period end total loans held for investment		2.42	%			3.04	%			2.42	%			3.04	%	
Net charge-offs (annualized) to average loans outstanding during the period		1.80	%			1.41	%			2.04	%			4.97	%	
Net charge-offs (annualized), excluding charge-offs related to the acquisition of mortgage loans from Doral, bulk loan sales and loans transferred to held for sale, to average loans outstanding during the period		1.80	%			1.41	%			1.94	%			1.87	%	
Provision for loan and lease losses to net charge-offs during the period		0.63x				0.66x				0.59x				0.60x		
Provision for loan and lease losses to net charge-offs during the period, excluding impact of the acquisition of mortgage loans from Doral, bulk loan sales, and the transfer of loans to held for sale		0.63x				0.66x				0.61x				0.66x		
(1)	For the nine-month period ended September 30, 2013, includes a provision totaling \$68.8 million associated with the bulk loan sales.															
(2)	For the nine-month period ended September 30, 2013, includes a provision of \$28.7 million associated with the bulk loan sales and the transfer of loans to held for sale.															
(3)	For the nine-month period ended September 30, 2014, includes a provision totaling \$1.4 million associated with the acquisition of mortgage loans from Doral.															
(4)	For the nine-month period ended September 30, 2013, includes a provision totaling \$20.8 million associated with the bulk loan sales.															
(5)	For nine-month period ended September 30, 2013, includes a provision totaling \$13.6 million associated with the bulk loan sales.															

Supplemental cash flow information is as follows:

(6)	For the nine-month period ended September 30, 2014, includes a provision of \$1.4 million associated with the acquisition of mortgage loans from Doral. For the nine-month period ended September 30, 2013, includes a provision totaling \$132.0 million associated with the bulk loan sales and the transfer of loans to held for sale.	
(7)	For the nine-month period ended September 30, 2013, includes charge-offs totaling \$99.0 million associated with the bulk loan sales.	
(8)	For the nine-month period ended September 30, 2013, includes charge-offs totaling \$54.6 million associated with the bulk loan sales and the transfers of loans to held for sale.	
(9)	For the nine-month period ended September 30, 2014, includes charge-offs totaling \$6.9 million associated with the acquisition of mortgage loans from Doral.	
(10)	For the nine-month period ended September 30, 2013, includes charge-offs totaling \$44.7 million associated with the bulk loan sales.	
(11)	For the nine-month period ended September 30, 2013, includes charge-offs totaling \$34.2 million, associated with the bulk loan sales and the transfer of loans to held for sale.	
(12)	For the nine-month period ended September 30, 2014, includes charge-offs totaling \$6.9 million associated with the acquisition of mortgage loans from Doral. For the nine-month period ended September 30, 2013, includes charge-offs totaling \$232.4 million, associated with the bulk loan sales and the transfer of loans to held for sale.	

The following table sets forth information concerning the allocation of the allowance for loan and lease losses by loan category and the percentage of loan balances in each category to the total of such loans as of the dates indicated:

(In thousands)	As of				As of			
	September 30, 2014				December 31, 2013			
	Amount		Percent of loans to total loans		Amount		Percent of loans to total loans	
Residential mortgage	\$	29,906	30 %	\$	33,110	27 %		
Commercial mortgage loans		52,415	19 %		73,138	19 %		
Construction loans		14,435	2 %		35,814	2 %		
Commercial and Industrial loans (including loan to a local financial institution in 2013)		63,476	27 %		85,295	31 %		
Consumer loans and finance leases		65,202	22 %		58,501	21 %		
	\$	225,434	100 %	\$	285,858	100 %		

The following table sets forth information concerning the composition of the Corporation's allowance for loan and lease losses as of September 30, 2014 and December 31, 2013 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance.

As of September 30, 2014	Residential Mortgage Loans	Commercial Mortgage Loans	C&I Loans	Construction Loans	Consumer and Finance Leases	Total
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	\$ 88,126	\$ 103,282	\$ 44,683	\$ 5,709	\$ 1,641	\$ 243,441
Impaired loans with specific reserves:						
Principal balance of	333,697	135,050	196,730	33,732	30,364	729,573

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

loans, net of charge-offs														
Allowance for loan and lease losses	11,658		14,128		21,268		2,935		5,295				55,284	
Allowance for loan and lease losses to principal														
balance	3.49 %		10.46 %		10.81 %		8.70 %		17.44 %				7.58 %	
PCI loans:														
Carrying value of PCI loans	99,535		3,418		-		-		1,360				104,313	
Allowance for PCI loans	-		-		-		-		-				-	
Allowance for PCI loans to carrying value	-		-		-		-		-				-	
Loans with general allowance:														
Principal balance of loans	2,298,290		1,570,344		2,273,971		102,248		1,993,222				8,238,075	
Allowance for loan and lease losses	18,248		38,287		42,208		11,500		59,907				170,150	
Allowance for loan and lease losses to principal														
balance	0.79 %		2.44 %		1.86 %		11.25 %		3.01 %				2.07 %	
Total loans held for investment:														
Principal balance of loans	\$ 2,819,648		\$ 1,812,094		\$ 2,515,384		\$ 141,689		\$ 2,026,587				\$ 9,315,402	
Allowance for loan and lease losses	29,906		52,415		63,476		14,435		65,202				225,434	
Allowance for loan and lease losses to principal														
balance (1)	1.06 %		2.89 %		2.52 %		10.19 %		3.22 %				2.42 %	

Supplemental cash flow information is as follows:


(Dollars in thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	C&I Loans	Construction Loans	Consumer and Finance Leases	Total								
<b>As of December 31, 2013</b>														
Impaired loans without specific reserves:														
Principal balance of loans, net of charge-offs	\$ 220,428	\$ 69,484	\$ 32,418	\$ 15,120	\$ 4,035	\$ 341,485								
Impaired loans with specific reserves:														
Principal balance of loans, net of charge-offs	190,566	149,888	154,686	57,597	24,890	577,627								
Allowance for loan and lease losses	18,125	32,189	26,686	22,144	3,457	102,601								
Allowance for loan and lease losses to principal balance	9.51 %	21.48 %	17.25 %	38.45 %	13.89 %	17.76 %								
PCI loans:														
Carrying value of PCI loans	-	-	-	-	4,791	4,791								
Allowance for PCI loans	-	-	-	-	-	-								
Allowance for PCI loans to carrying value	-	-	-	-	-	-								

Supplemental cash flow information is as follows:



Loans with general allowance:																				
Principal balance of loans	2,138,014			1,604,236			2,841,218			95,996			2,032,803			8,712,267				
Allowance for loan and lease losses	14,985			40,949			58,609			13,670			55,044			183,257				
Allowance for loan and lease losses to principal balance	0.70 %			2.55 %			2.06 %			14.24 %			2.71 %			2.10 %				
Total loans held for investment:																				
Principal balance of loans	\$ 2,549,008			\$ 1,823,608			\$ 3,028,322			\$ 168,713			\$ 2,066,519			\$ 9,636,170				
Allowance for loan and lease losses	33,110			73,138			85,295			35,814			58,501			285,858				
Allowance for loan and lease losses to principal balance (1)	1.30 %			4.01 %			2.82 %			21.23 %			2.83 %			2.97 %				
(1)	Loans used in the denominator include PCI loans of \$104.3 million and \$4.8 million as of September 30, 2014 and December 31, 2013, respectively. However, the Corporation separately tracks and reports PCI loans and excludes these loans from non-performing loans, impaired loans, TDRs and non-performing assets statistics.																			

The following tables show the activity for impaired loans held for investment and the related specific reserve during the quarter and nine-month period ended September 30, 2014:					
		Quarter Ended			Nine-month period ended
		September 30, 2014			
		(In thousands)			
<b>Impaired Loans:</b>					
Balance at beginning of period	\$		908,858	\$	919,112
Loans determined impaired during the period			118,549		271,792
Charge-offs			(31,263)		(95,948)
Increase to impaired loans - additional disbursements			1,768		2,687
Foreclosures			(5,332)		(13,472)
Loans no longer considered impaired			(1,009)		(18,740)
Paid in full or partial payments			(18,557)		(92,417)
Balance at end of period	\$		973,014	\$	973,014
		Quarter Ended			Nine-month period ended
		September 30, 2014			
		(In thousands)			
<b>Specific Reserve:</b>					
Balance at beginning of period	\$		68,358	\$	102,601
Provision for loan losses			18,189		48,631
Charge-offs			(31,263)		(95,948)
Balance at end of period	\$		55,284	\$	55,284

### *Credit Quality*

As of September 30, 2014, total non-performing assets were \$744.4 million, an increase of \$19.0 million from December 31, 2013. Total non-performing loans, including non-performing loans held for sale, increased by \$63.8 million, or 12%, from December 31, 2013. The increase was primarily reflected in the non-performing commercial mortgage and C&I loan portfolios, driven by the inflow of three large commercial relationships totaling \$83.8 million. In addition, the non-performing residential mortgage loan portfolio increased by \$23.6 million. These increases were partially offset by a \$28.8 million decrease in non-performing construction loans, mainly driven by charge-offs, the restoration to accrual status of a \$10.7 million loan that is current in payments and deemed collectible, loans paid off in Florida and foreclosures. Inflows of non-performing loans held for investment decreased by \$25.4 million, or 7%, compared to inflows in the first nine months of 2013. The decrease was primarily reflected in the commercial mortgage and residential mortgage loan portfolios.

The level of adversely classified commercial and construction loans, including non-performing loans held for sale, decreased by \$51.8 million to \$626.0 million, or a 7% decrease, compared to the balance as of December 31, 2013, driven by certain loans paid off in both Puerto Rico and the United States, charge-offs and the upgrade of the \$10.7 million construction loan in Puerto Rico that was restored to accrual status.

The net charge-off activity decreased to \$146.1 million in the first nine months of 2014, compared to net charge-offs of \$366.8 million for the same period in 2013. The fair value adjustments related to mortgage loans acquired from Doral in 2014 and the bulk sales of assets and the transfer of certain loans to held for sale in 2013 added \$6.9 million and \$232.4 million in charge-offs in the first nine months of 2014 and 2013, respectively. Adjusted net charge-offs, excluding the impact of charge-offs resulting from the Doral transaction, the bulk sales of assets and the transfer of loans to held for sale, amounted to \$139.2 million, or an annualized 1.94% of average loans, an increase of \$4.8 million compared to the first nine months of 2013, mainly reflecting higher charge-offs in the consumer loans portfolio.

The OREO portfolio decreased by \$47.4 million from December 31, 2013, driven by sales of \$50.8 million and adjustments to value of \$15.9 million, partially offset by additions. Given the prolonged recession and uncertainties in the economic environment in Puerto Rico, the Corporation continued to face pressures related to its non-performing loans and charge-off levels. The Corporation continues to emphasize its loan resolution and liquidation strategies.

### *Non-performing Loans and Non-performing Assets*

Total non-performing assets consist of non-performing loans (generally loans held for investment or loans held for sale on which the recognition of interest income was discontinued when the loan became 90 days past due or earlier if the full and timely collection of interest or principal is uncertain), foreclosed real estate and other repossessed properties. When a loan is placed in non-performing status, any interest previously recognized and not collected is reversed and charged against interest income.

*Non-performing Loans Policy*

*Residential Real Estate Loans* — The Corporation classifies real estate loans in non-performing status when interest and principal have not been received for a period of 90 days or more.

*Commercial and Construction Loans* — The Corporation places commercial loans (including commercial real estate and construction loans) in non-performing status when interest and principal have not been received for a period of 90 days or more or when collection of all of the principal or interest is not expected due to deterioration in the financial condition of the borrower.

*Finance Leases* — Finance leases are classified in non-performing status when interest and principal have not been received for a period of 90 days or more.

*Consumer Loans* — Consumer loans are classified in non-performing status when interest and principal have not been received for a period of 90 days or more. Credit card loans continue to accrue finance charges and fees until charged-off at 180 days delinquent.

*PCI Loans* — PCI loans were recorded at fair value at acquisition. Since the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the subsequent accounting for PCI loans differs from the accounting for non-PCI loans. The Corporation, therefore, separately tracks and reports PCI loans and excludes these from its non-performing loans, impaired loans, Troubled Debt Restructurings (“TDRs”), and non-performing assets statistics.

Cash payments received on certain loans that are impaired and collateral dependent are recognized when collected in accordance with the contractual terms of the loans. The principal portion of the payment is used to reduce the principal balance of the loan, whereas the interest portion is recognized on a cash basis (when collected). However, when management believes that the ultimate collectability of principal is in doubt, the interest portion is applied to principal. The risk exposure of this portfolio is diversified as to individual borrowers and industries, among other factors. In addition, a large portion is secured with real estate collateral.

#### ***Other Real Estate Owned***

OREO acquired in settlement of loans is carried at the lower of cost (carrying value of the loan) or fair value less estimated costs to sell the real estate. Appraisals are obtained periodically, generally, on an annual basis.

#### ***Other Repossessed Property***

The other repossessed property category generally includes repossessed boats and autos acquired in settlement of loans. Repossessed boats and autos are recorded at the lower of cost or estimated fair value.

#### ***Past Due Loans 90 days and still accruing***

Supplemental cash flow information is as follows:

These are accruing loans that are contractually delinquent 90 days or more. These past due loans are either current as to interest but delinquent as to the payment of principal or are insured or guaranteed under applicable FHA and VA programs. Past Due Loans 90 days and still accruing also includes PCI loans with individual delinquencies over 90 days, primarily related to mortgage loans acquired from Doral.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan.

The following table presents non-performing assets as of the dates indicated:							
		September 30,			December 31,		
(Dollars in thousands)		2014			2013		
Non-performing loans held for investment:							
Residential mortgage	\$	185,025		\$	161,441		
Commercial mortgage		169,967			120,107		
Commercial and Industrial		130,917			114,833		
Construction		30,111			58,866		
Finance leases		4,501			3,082		
Consumer		38,995			37,220		
Total non-performing loans held for investment	\$	559,516		\$	495,549		
OREO		112,803			160,193		
Other repossessed property		17,467			14,865		
Total non-performing assets, excluding loans held for sale	\$	689,786		\$	670,607		
Non-performing loans held for sale							
Total non-performing assets, including loans held for sale (1) (2)	\$	744,427		\$	725,408		
Past due loans 90 days and still accruing (3) (4)	\$	143,535		\$	120,082		
Non-performing assets to total assets		5.89	%		5.73	%	
Non-performing loans held for investment to total loans held for investment		6.01	%		5.14	%	
Allowance for loan and lease losses	\$	225,434		\$	285,858		
Allowance to total non-performing loans held for investment		40.29	%		57.69	%	
Allowance to total non-performing loans held for investment, excluding residential real estate loans		60.20	%		85.56	%	
(1)	Purchased credit impaired loans accounted for under ASC 310-30 of \$104.3 million and \$4.8 million as of September 30, 2014 and December 31, 2013, respectively, are excluded and not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.						
(2)	Non-performing assets excluded \$485.1 million and \$425.4 million of TDRs loans that are in compliance with modified terms and in accrual status as of September 30, 2014 and December 31, 2013, respectively.						
(3)	It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past due loans 90 days and still accruing as opposed to						

Supplemental cash flow information is as follows:

	non-performing loans since the principal repayment is insured. These balances include \$41.4 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 18 months delinquent, and are no longer accruing interest as of September 30, 2014.
(4)	Amount includes purchased credit impaired loans with individual delinquencies over 90 days and still accruing with a carrying value as of September 30, 2014 of approximately \$15.6 million, primarily related to loans acquired from Doral.



The following table shows non-performing assets by geographic segment:						
		September 30,			December 31,	
(Dollars in thousands)		2014			2013	
<b>Puerto Rico:</b>						
Non-performing loans held for investment:						
Residential mortgage	\$	159,740		\$	139,771	
Commercial mortgage		147,909			101,255	
Commercial and Industrial		124,406			109,224	
Construction		25,780			43,522	
Finance leases		4,501			3,082	
Consumer		36,722			34,660	
Total non-performing loans held for investment		499,058			431,514	
OREO		99,721			123,851	
Other repossessed property		17,437			14,806	
Total non-performing assets, excluding loans held for sale	\$	616,216		\$	570,171	
Non-performing loans held for sale		14,636			14,796	
Total non-performing assets, including loans held for sale (1)	\$	630,852		\$	584,967	
Past due loans 90 days and still accruing (2)	\$	140,229		\$	118,097	
<b>Virgin Islands:</b>						
Non-performing loans held for investment:						
Residential mortgage	\$	13,576		\$	8,439	
Commercial mortgage		7,044			6,827	
Commercial and Industrial		6,511			5,609	
Construction		4,173			11,214	
Consumer		861			514	
Total non-performing loans held for investment		32,165			32,603	
OREO		7,904			14,894	
Other repossessed property		3			5	
Total non-performing assets, excluding loans held for sale	\$	40,072		\$	47,502	
Non-performing loans held for sale		40,005			40,005	
Total non-performing assets, including loans held for sale	\$	80,077		\$	87,507	
Past due loans 90 days and still accruing	\$	2,766		\$	1,985	
<b>United States:</b>						

Non-performing loans held for investment:					
Residential mortgage	\$	11,709		\$	13,231
Commercial mortgage		15,014			12,025
Construction		158			4,130
Consumer		1,412			2,046
Total non-performing loans held for investment		28,293			31,432
OREO		5,178			21,448
Other repossessed property		27			54
Total non-performing assets, excluding loans held for sale	\$	33,498		\$	52,934
Non-performing loans held for sale		-			-
Total non-performing assets, including loans held for sale	\$	33,498		\$	52,934
Past due loans 90 days and still accruing	\$	540		\$	-
(1)	Purchased credit impaired loans accounted for under ASC 310-30 of \$104.3 million and \$4.8 million as of September 30, 2014 and December 31, 2013, respectively, are excluded and not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.				
(2)	Amount includes purchased credit impaired loans with individual delinquencies over 90 days and still accruing with a carrying value as of September 30, 2014 of approximately \$15.6 million, primarily related to loans acquired from Doral.				

Total non-performing loans, including non-performing loans held for sale, were \$614.2 million as of September 30, 2014. This represents an increase of \$63.8 million, or 12%, from \$550.4 million as of December 31, 2013. The increase was primarily reflected in the non-performing commercial mortgage and C&I loan portfolios, driven by the inflow of three large commercial relationships totaling \$83.8 million.

Non-performing commercial mortgage loans, including non-performing commercial mortgage loans held for sale, increased by \$49.7 million, or 39%, from December 31, 2013. The increase was primarily driven by the inflow of two large relationships totaling \$53.1 million in Puerto Rico. The inflow of these collateral dependent loans did not require an increase in the related specific reserve assigned to these loans. In addition, there were inflows of three loans in Florida totaling \$4.1 million. These increases were partially offset by charge-offs, including charge-offs of \$13.4 million on two commercial mortgage relationships in Puerto Rico. Non-performing commercial mortgage loans increased by \$46.5 million, \$3.0 million, and \$0.2 million in Puerto Rico, the United States, and the Virgin Islands, respectively, from December 31, 2013 levels. Total inflows of non-performing commercial mortgage loans of \$80.1 million during the first nine months of 2014 decreased by \$22.5 million compared to \$102.6 million for the same period in 2013.

Non-performing C&I loans increased by \$16.1 million compared to December 31, 2013, driven by the inflow of a \$21.2 million loan in Puerto Rico, and inflows of eight loans individually in excess of \$2 million totaling \$36.0 million, also in Puerto Rico. This was partially offset by charge-offs and principal repayments, including charge-offs amounting to \$38.1 million related to eleven collateral dependent loans in Puerto Rico. Total inflows of non-performing C&I loans increased to \$89.2 million during the first nine months of 2014 compared to inflows of \$39.0 million for the same period in 2013.

Non-performing construction loans, including non-performing construction loans held for sale, decreased by \$28.8 million, or 29%, from December 31, 2013, primarily reflecting charge-offs of \$11.1 million, the restoration to accrual status of a \$10.7 million loan in Puerto Rico that is current in payments and deemed collectible, two loans paid off in the United States totaling \$4.1 million, a \$1.7 million loan transferred to the OREO portfolio in the Virgin Islands, and a loan of \$1.0 million paid off in Puerto Rico. The inflows of non-performing construction loans of \$2.0 million during the first nine months of 2014 decreased compared to inflows of \$17.9 million for the same period in 2013.

The following table presents the activity of commercial and construction non-performing loans held for investment:									
					Commercial Mortgage			Commercial & Industrial	Construction
(In thousands)									
<b>Quarter ended September 30, 2014</b>									
Beginning balance				\$	166,218	\$	143,669	\$	38,830
Plus:									
Additions to non-performing					11,985		13,967		122
Less:									
Non-performing loans transferred to REO					(1,058)		(3,109)		(749)
Non-performing loans charged-off					(2,292)		(17,570)		(7,689)
Loans returned to accrual status/loan collections					(4,886)		(6,040)		(403)
Ending balance				\$	169,967	\$	130,917	\$	30,111
					Commercial Mortgage			Commercial & Industrial	Construction
(In thousands)									
<b>Nine-Month Period Ended September 30, 2014</b>									
Beginning balance				\$	120,107	\$	114,833	\$	58,866
Plus:									
Additions to non-performing					80,108		89,179		2,024
Less:									
Non-performing loans transferred to REO					(1,864)		(5,150)		(2,968)
Non-performing loans charged-off					(21,524)		(44,441)		(11,069)
Loans returned to accrual status/loan collections					(8,035)		(22,329)		(16,742)
Reclassification					1,175		(1,175)		-
Ending balance				\$	169,967	\$	130,917	\$	30,111

Supplemental cash flow information is as follows:



Non-performing commercial and construction loans held for sale remained relatively flat at \$54.6 million as of September 30, 2014, a \$0.2 million decrease from December 31, 2013.

Total non-performing commercial and construction loans, including non-performing loans held for sale, with a book value of \$385.6 million as of September 30, 2014 are being carried at 57.9% of unpaid principal balance, net of reserves and accumulated charge-offs.

Non-performing residential mortgage loans increased by \$23.6 million, or 15%, from December 31, 2013. The increase was mainly driven by inflows of \$100.5 million during the first nine months of 2014, partially offset by loans brought current, foreclosures, and charge-offs. The inflows of non-performing residential mortgage loans of \$100.5 million during the first nine months of 2014 decreased compared to inflows of \$142.8 million for the same period in 2013. Most of the loans included in the bulk sale of non-performing residential assets that was completed in the second quarter of 2013 were at a late stage of the foreclosure process; thus, foreclosures and charge-offs that in the past offset the inflows of loans to non-performing status significantly decreased since the completion of the bulk sale. Approximately \$106.7 million, or 57% of total non-performing residential mortgage loans, have been written down to their net realizable value.

The following table presents the activity of residential non-performing loans held for investment:							
				Quarter			Nine-Month
				Ended			Period Ended
				September 30, 2014			
				(In thousands)			
Beginning balance			\$	175,404		\$	161,441
Plus:							
	Additions to non-performing			35,645			100,509
Less:							
	Non-performing loans transferred to REO			(2,216)			(5,267)
	Non-performing loans charged-off			(4,445)			(13,632)
	Loans returned to accrual status/loan collections			(19,363)			(58,026)
Ending balance			\$	185,025		\$	185,025

The amount of non-performing consumer loans, including finance leases, increased by \$3.2 million during the first nine months of 2014. The inflows of non-performing consumer loans of \$53.6 million increased by \$5.0 million compared to inflows of \$48.6 million for the same period in 2013.

Supplemental cash flow information is as follows:

As of September 30, 2014, approximately \$135.3 million of the loans placed in non-accrual status, mainly construction and commercial loans, were current, or had delinquencies of less than 90 days in their interest payments, including \$65.8 million of TDRs maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability. Collections on these loans are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the nine-month period ended September 30, 2014, interest income of approximately \$4.1 million related to non-performing loans with a carrying value of \$337.3 million as of September 30, 2014, mainly non-performing construction and commercial loans, was applied against the related principal balances under the cost-recovery method.

The allowance to non-performing loans held for investment ratio as of September 30, 2014 was 40.29%, compared to 57.69% as of December 31, 2013. As of September 30, 2014, approximately \$221.4 million, or 39.57%, of total non-performing loans are carried at their net realizable value, as shown in the following table:												
(Dollars in thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	C&I Loans	Construction Loans	Consumer and Finance Leases	Total						
<b>As of September 30, 2014</b>												
Non-performing loans held for investment												
charged-off to realizable value	\$ 106,702	\$ 66,992	\$ 44,247	\$ 1,888	\$ 1,551	\$ 221,380						
Other non-performing loans held												
for investment	78,323	102,975	86,670	28,223	41,945	338,136						
Total non-performing loans held												
for investment	\$ 185,025	\$ 169,967	\$ 130,917	\$ 30,111	\$ 43,496	\$ 559,516						
Allowance to non-performing loans held for investment	16.16 %	30.84 %	48.49 %	47.94 %	149.90 %	40.29 %						
Allowance to non-performing loans held for investment, excluding non-performing loans charged-off to realizable value	38.18 %	50.90 %	73.24 %	51.15 %	155.45 %	66.67 %						
<b>As of December 31, 2013</b>												
Non-performing loans held for investment												
charged-off to realizable value	\$ 100,181	\$ 32,961	\$ 29,769	\$ 11,603	\$ 1,192	\$ 175,706						

Supplemental cash flow information is as follows:



Other non-performing loans held																			
for investment		61,260			87,146			85,064			47,263			39,110				319,843	
Total non-performing loans held																			
for investment	\$	161,441		\$	120,107		\$	114,833		\$	58,866		\$	40,302		\$		495,549	
Allowance to non-performing loans held for																			
investment		20.51	%		60.89	%		74.28	%		60.84	%		145.16	%			57.69	%
Allowance to non-performing loans held for																			
investment, excluding non-performing loans																			
charged-off to realizable value		54.05	%		83.93	%		100.27	%		75.78	%		149.58	%			89.37	%

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans in the U.S. mainland fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of September 30, 2014, the Corporation's total TDR loans held for investment of \$701.1 million consisted of \$348.4 million of residential mortgage loans, \$174.3 million of commercial and industrial loans, \$134.9 million of commercial mortgage loans, \$13.2 million of construction loans, and \$30.2 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to \$0.2 million as of September 30, 2014.

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently (offered up to 2010) or for a period of up to two years (step-up rates). Additionally, in certain cases, the restructuring may provide for the forgiveness of contractually due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available only to those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in a foreclosure action absent some lender concession. Nevertheless, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in or that have been offered a binding trial modification are classified as TDRs when the trial offer is made and continue to be classified as TDRs regardless of whether the borrower enters into a permanent modification. As of September 30, 2014, we classified an additional \$11.2 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collections function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of the commercial and industrial, commercial mortgage and

Supplemental cash flow information is as follows:

construction loan portfolios, the Corporation's Special Asset Group ("SAG") focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists, and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third-party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and assists with the restructuring of large commercial loans.

In addition, the Corporation extends, renews, and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which are mainly one year in term and therefore are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon changes in the borrower's business needs, use of funds, timing of completion of projects, and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals, and restructurings are done in the normal course of business and not considered concessions, and the loans continue to be recorded as performing.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation's interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and OREO costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses.

The following table provides a breakdown between accrual and nonaccrual status of TDRs:										
(In thousands)		September 30, 2014								
		Accrual			Nonaccrual (1)(2)			Total TDRs		
Non-FHA/VA Residential Mortgage loans		\$	259,749		\$	88,697		\$	348,446	
Commercial Mortgage Loans			72,601			62,333			134,934	
Commercial and Industrial Loans			127,178			47,119			174,297	
Construction Loans:										
	Land		972			2,295			3,267	
	Construction-residential		3,371			6,589			9,960	
Consumer Loans - Auto			9,584			6,149			15,733	
Finance Leases			1,916			247			2,163	
Consumer Loans - Other			9,712			2,631			12,343	
Total Troubled Debt Restructurings		\$	485,083		\$	216,060		\$	701,143	
(1)	Included in non-accrual loans are \$65.8 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability.									

Supplemental cash flow information is as follows:

(2)	Excludes non-accrual TDRs held for sale with a carrying value of \$45.7 million as of September 30, 2014.

The OREO portfolio, which is part of non-performing assets, decreased by \$47.4 million. The following table shows the activity during the nine-month period ended September 30, 2014 of the OREO portfolio by geographic region and type of property:

(In thousands)	As of September 30, 2014											
	Puerto Rico			Virgin Islands			Florida			Consolidated		
	Residential	Commercial	Construction	Residential	Commercial	Construction	Residential	Commercial	Construction	Residential	Commercial	Construction
Beginning Balance	\$ 34,875	\$ 72,845	\$ 16,131	\$ 2,184	\$ 2,002	\$ 10,708	\$ 3,227	\$ 15,625	\$ 2,596	\$ 16,131	\$ 16,131	\$ 16,131
Additions	10,956	4,116	760	322	58	2,229	872	-	-	1,000	1,000	1,000
Sales	(12,997)	(7,783)	(4,891)	(715)	(1,830)	(6,429)	(1,550)	(14,057)	(570)	(570)	(570)	(570)
Fair value adjustments	(5,367)	(7,806)	(1,118)	(282)	-	(343)	(102)	(560)	(303)	(303)	(303)	(303)
Ending balance	\$ 27,467	\$ 61,372	\$ 10,882	\$ 1,509	\$ 230	\$ 6,165	\$ 2,447	\$ 1,008	\$ 1,723	\$ 11,000	\$ 11,000	\$ 11,000

#### Net Charge-offs and Total Credit Losses

Total net charge-offs for the first nine months of 2014 were \$146.1 million, or 2.04% of average loans on an annualized basis, compared to net charge-offs of \$366.8 million, or an annualized 4.97%, for the same period in 2013. The fair value adjustments related to mortgage loans acquired from Doral in 2014 and the bulk sales of assets and the transfer of certain loans to held for sale in 2013 added \$6.9 million and \$232.4 million in charge-offs in the first nine months of 2014 and 2013, respectively. Adjusted net charge-offs, excluding the impact of charge-offs resulting from the Doral transaction, the bulk sales of assets and the transfer of loans to held for sale, amounted to \$139.2 million, or an annualized 1.94% of average loans, an increase of \$4.8 million compared to the first nine months of 2013, mainly reflecting higher charge-offs in the consumer loan portfolio.

C&I loans net charge-offs in the first nine months of 2014 totaled \$57.3 million, or an annualized 2.72% of related average loans, compared to \$96.1 million, or an annualized 4.30%, for the first nine months of 2013. C&I loans net charge-offs in the first nine months of 2014 included \$6.9 million associated with the acquisition of mortgage loans from Doral and net charge-offs in the first nine months of 2013 included \$44.7 million of charge-offs related to the bulk sales. Excluding the impact of charge-offs related to the acquisition of mortgage loans from Doral and the bulk sales, C&I net charge-offs for the first nine months of 2014 were \$1.0 million lower than in the same period in 2013. Substantially all of the charge-offs recorded in the first nine months of 2014 were in Puerto Rico, including individual charge-offs in excess of \$2 million associated with six collateral dependent loans in Puerto Rico totaling \$31.3 million and a \$7.0 million charge-off associated with a \$37.0 million adversely classified loan paid off in Puerto Rico.

Commercial mortgage loans net charge-offs in the first nine months of 2014 were \$13.8 million, or an annualized 1.00% of related average loans, compared to \$65.2 million, or an annualized 4.80%, for the first nine months of 2013. Commercial mortgage loans net charge-offs in the first nine months of 2013 included \$54.6 million of charge-offs related to the bulk sale and the transfer of loans to held for sale in 2013. Excluding the impact of charge-offs related to the bulk sale and the transfer of loans to held for sale, commercial mortgage loans net charge-offs for the first nine months of 2014 were \$3.2 million higher than in the same period in 2013. Commercial mortgage loans net

Supplemental cash flow information is as follows:

charge-offs in the first nine months of 2014 were primarily in Puerto Rico, including \$15.5 million on three relationships, partially offset by recoveries of \$7.8 million in the United States region.

Construction loans net charge-offs in the first nine months of 2014 were \$6.2 million, or an annualized 4.04% of related average loans, compared to \$40.8 million, or an annualized 18.60%, for the first nine months of 2013. Construction loans net charge-offs in the first nine months of 2013 included \$34.2 million of charge-offs related to the bulk sale and the transfer of loans to held for sale. Excluding the impact of charge-offs related to the bulk sale and the transfer of loans to held for sale, construction net charge-offs for the first nine months of 2014 were \$0.4 million lower than in the same period in 2013, primarily due to higher recoveries in both Puerto Rico and Florida regions. Recoveries of previously amounts charged-off for construction loans for the first nine months of 2014 were \$3.1 million in the United States and \$2.0 million in Puerto Rico.

Residential mortgage loans net charge-offs in the first nine months of 2014 were \$16.8 million, or an annualized 0.84% of related average loans, compared to \$123.5 million, or an annualized 6.03%, for the first nine months of 2013. Residential mortgage loans net charge-offs in the first nine months of 2013 included \$99.0 million of charge-offs related to the bulk sales. Excluding the impact of charge-offs related to the bulk sales, residential mortgage loans net charge-offs for the first nine months of 2014 were \$7.7 million lower than in the same period in 2013 mainly due to a reduced amount of impaired loans and foreclosures after the bulk sale completed in the second quarter of 2013 and a reduced amount of delinquent loans repurchased.

Approximately \$13.3 million in charge-offs for the first nine months of 2014 resulted from valuations for impairment purposes of residential mortgage loans considered homogeneous given high delinquency and loan-to-value levels, compared to \$13.8 million in the first nine months of 2013. Net charge-offs on residential mortgage loans also included \$3.0 million related to foreclosures, compared to \$6.5 million in the first nine months of 2013.

Net charge-offs of consumer loans and finance leases in the first nine months of 2014 were \$52.1 million, or an annualized 3.37% of related average loans, compared to \$41.3 million, or an annualized 2.71% of average loans, in the first nine months of 2013. The increase is mainly attributable to the auto loan portfolio.

The following table presents annualized net charge-offs (recoveries) to average loans held-in-portfolio:												
		Quarter Ended						Nine-Month Period Ended				
		September 30, 2014			September 30, 2013			September 30, 2014		September 30, 2013		
Residential mortgage loans (1)		0.82	%		1.31	%		0.84	%		6.03	%
Commercial mortgage (2)		(0.24)	%		1.23	%		1.00	%		4.80	%
Commercial and industrial (3) (4)		2.54	%		0.81	%		2.72	%		4.30	%
Construction loans (5)		6.57	%		(0.11)	%		4.04	%		18.60	%
Consumer loans (6)		3.62	%		2.71	%		3.37	%		2.71	%
Total loans (7) (8)		1.80	%		1.41	%		2.04	%		4.97	%
(1)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$99.0 million, associated with the bulk sales of assets. For the nine-month period ended September 30, 2013, the ratio of residential mortgage net-charge offs to average loans, excluding charge-offs associated with the bulk loan sale, was 1.26%.											
(2)	For the nine-month period ended September 30, 2013, includes net charge-offs of \$54.6 million associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale in the first quarter of 2013. The ratio of commercial mortgage net-charge offs to average loans, excluding charge-offs associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale, was 0.81%.											
(3)	For the nine-month period ended September 30, 2014, includes net charge-offs totaling \$6.9 million associated with the acquisition of mortgage loans from Doral. The ratio of commercial and industrial net charge-offs to average loans, excluding charge-offs associated with the acquisition of mortgage loans from Doral, was 2.51%.											
(4)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$44.7 million associated with the bulk sale of adversely classified commercial assets. The ratio of commercial and industrial net-charge offs to average loans, excluding charge-offs associated with the bulk sale of adversely classified commercial assets, was 2.33%.											
(5)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$34.2 million, associated with the bulk sales of assets. For the nine-month period ended September 30, 2013, the ratio of construction net-charge offs to average loans, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was 3.50%.											



(6)	Includes lease financing.
(7)	For the nine-month period ended September 30, 2014, includes net charge-offs totaling \$6.9 million associated with the acquisition of mortgage loans from Doral. The ratio of commercial and industrial net charge-offs to average loans, excluding charge-offs associated with the acquisition of mortgage loans from Doral, was 1.94%.
(8)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$232.4 million, associated with the bulk loan sales and the transfer of loans to held for sale. For the nine-month period ended September 30, 2013, the ratio of total net-charge offs to average loans, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was 1.87%.

The above ratios are based on annualized charge-offs and are not necessarily indicative of the results expected for the entire year or in subsequent periods.

The following table presents annualized net charge-offs (recoveries) to average loans held-in-portfolio by geographic segment:											
		Quarter Ended				Nine-Month Period Ended					
		September 30,		September 30,		September 30,		September 30,			
		2014		2013		2014		2013			
<b>PUERTO RICO:</b>											
Residential mortgage (1)		1.08%		1.66%		1.10%		7.42%			
Commercial mortgage (2)		0.71%		0.26%		1.93%		5.66%			
Commercial and Industrial (3) (4)		3.14%		0.84%		3.17%		4.58%			
Construction (5)		7.97%		0.68%		5.84%		17.85%			
Consumer and finance leases		3.74%		2.80%		3.49%		2.78%			
Total loans (6) (7)		2.34%		1.39%		2.54%		5.34%			
<b>VIRGIN ISLANDS:</b>											
Residential mortgage (8)		0.01%		0.36%		0.08%		2.47%			
Commercial mortgage		0.00%		0.42%		0.13%		0.15%			
Commercial and Industrial (11)		-1.52%		0.99%		-0.47%		1.69%			
Construction (9) (12)		22.06%		-4.00%		8.60%		23.08%			
Consumer and finance leases		0.28%		0.16%		0.36%		0.38%			
Total loans (10) (13)		1.92%		-0.03%		0.88%		4.49%			
<b>FLORIDA:</b>											
Residential mortgage (14)		-0.04%		0.16%		0.01%		0.36%			
Commercial mortgage (15)		-4.67%		6.10%		-3.09%		1.99%			
Commercial and Industrial		0.00%		0.00%		0.00%		0.16%			
Construction (16)		-46.50%		6.39%		-17.09%		8.95%			
Consumer and finance leases		1.32%		0.75%		0.54%		1.70%			
Total loans (17)		-2.58%		2.74%		-1.49%		1.36%			

Supplemental cash flow information is as follows:

(1)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$92.9 million, associated with the bulk loan sales. For the nine-month period ended September 30, 2013, the ratio of residential mortgage net-charge offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sales, was 1.57%.					
(2)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$54.6 million associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale. For the nine-month period ended September 30, 2013, the ratio of commercial mortgage net-charge offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale, was 0.56%.					
(3)	For the nine-month period ended September 30, 2014, includes net charge-offs totaling \$6.9 million associated with the acquisition of mortgage loans from Doral. The ratio of commercial and industrial net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with the acquisition of mortgage loans from Doral, was 2.94%.					
(4)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$44.7 million associated with the bulk sale of adversely classified commercial assets. For the nine-month period ended September 30, 2013, the ratio of commercial and industrial net-charge offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sale of adversely classified commercial assets, was 2.44%.					
(5)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$19.0 million associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale. For the nine-month period ended September 30, 2013, the ratio of construction net-charge offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk sale of adversely classified commercial assets and the transfer of loans to held for sale, was 5.15%.					
(6)	For the nine-month period ended September 30, 2014, includes net charge-offs totaling \$6.9 million associated with the acquisition of mortgage loans from Doral. The ratio of total net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with the acquisition of mortgage loans from Doral for the nine-month period ended September 30, 2014, was 2.42%.					
(7)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$211.2 million, associated with the bulk loan sales and the transfer of loans to held for sale. For the nine-month period ended September 30, 2013, the ratio of total net-charge offs to average loans in Puerto Rico, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was 2.05%.					
(8)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$6.1 million associated with the bulk sale of non-performing residential assets. For the nine-month period ended September 30, 2013, the ratio of residential mortgage net-charge offs to average loans in the Virgin Islands, excluding charge-offs associated with the bulk sale of non-performing residential assets, was 0.29%.					
(9)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$15.2 million, associated with the bulk loan sales and the transfer of loans to held for sale. For the nine-month period ended September 30, 2013, the ratio of construction loans net-charge offs to average loans in the Virgin Islands, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was -0.92%.					
(10)	For the nine-month period ended September 30, 2013, includes net charge-offs totaling \$21.3 million, associated with the bulk loan sales and the transfer of loans to held for sale. For the nine-month period ended September 30, 2013, the ratio of total net-charge offs to average loans in the Virgin Islands, excluding charge-offs associated with the bulk loan sales and the transfer of loans to held for sale, was 0.37%.					
(11)	For the third quarter and nine-month period ended September 30, 2014, recoveries in commercial and industrial loans in the Virgin Islands exceeded charge-offs.					

(12)	For the third quarter of 2013, recoveries in construction loans in the Virgin Islands exceeded charge-offs.
(13)	For the third quarter of 2013, recoveries in total loans in the Virgin Islands exceeded charge-offs.
(14)	For the third quarter of 2014, recoveries in residential mortgage loans in Florida exceeded charge-offs.
(15)	For the third quarter and nine-month period ended September 30, 2014, recoveries in commercial mortgage loans in Florida exceeded charge-offs.
(16)	For the third quarter and nine-month period ended September 30, 2014, recoveries in construction loans in Florida exceeded charge-offs.
(17)	For the third quarter and nine-month period ended September 30, 2014, recoveries in total loans in Florida exceeded charge-offs.

Total credit losses (equal to net charge-offs plus losses on OREO operations) for the first nine months of 2014 amounted to \$163.0 million, or 2.24% on an annualized basis to average loans and repossessed assets in contrast to credit losses of \$396.0 million, or 5.27% on an annual basis to average loans, for the same period in 2013, including the results of the bulk sales.

The following table presents a detail of the OREO inventory and credit losses for the periods indicated:												
	Quarter Ended						Nine-Month Period Ended					
	September 30,						September 30,					
	2014		2013		2014		2013		2014		2013	
	(Dollars in thousands)											
<b>OREO</b>												
OREO balances, carrying value:												
Residential	\$	31,423		\$	41,694		\$	31,423		\$	41,694	
Commercial		62,610			57,378			62,610			57,378	
Construction		18,770			34,212			18,770			34,212	
Total	\$	112,803		\$	133,284		\$	112,803		\$	133,284	
OREO activity (number of properties):												
Beginning property inventory		468			533			496			716	
Properties acquired		57			37			154			268	
Properties disposed		(58)			(69)			(183)			(483)	
Ending property inventory		467			501			467			501	
Average holding period (in days)												
Residential		540			411			540			411	
Commercial		491			456			491			456	
Construction		776			529			776			529	
		555			461			555			461	
OREO operations (loss) gain:												
Market adjustments and (losses) gain on sale:												
Residential	\$	(1,478)		\$	(1,429)		\$	(4,659)		\$	(8,828)	
Commercial		(638)			(2,757)			(6,442)			(5,768)	
Construction		(959)			(978)			(1,496)			(7,292)	
		(3,075)			(5,164)			(12,597)			(21,888)	
Other OREO operations expenses		(1,251)			(1,888)			(4,344)			(7,303)	

Supplemental cash flow information is as follows:

<b>Net Loss on OREO operations</b>	\$	(4,326)			\$	(7,052)			\$	(16,941)			\$	(29,191)	
<b>CHARGE-OFFS</b>															
Residential charge-offs, net		(5,734)				(8,457)				(16,774)				(123,455)	
Commercial charge-offs, net		(15,315)				(11,636)				(71,048)				(161,274)	
Construction charge-offs, net		(3,205)				71				(6,164)				(40,812)	
Consumer and finance leases charge-offs, net		(18,488)				(13,841)				(52,096)				(41,276)	
Total charge-offs, net		(42,742)				(33,863)				(146,082)				(366,817)	
<b>TOTAL CREDIT LOSSES (1)</b>	\$	(47,068)			\$	(40,915)			\$	(163,023)			\$	(396,008)	
<b>LOSS RATIO PER CATEGORY (2)</b>															
Residential		1.02	%			1.51	%			1.06	%			6.31	%
Commercial		1.42	%			1.20	%			2.19	%			4.59	%
Construction		7.61	%			1.31	%			4.55	%			19.94	%
Consumer		3.59	%			2.69	%			3.34	%			2.69	%
<b>TOTAL CREDIT LOSS RATIO (3)</b>		<b>1.96</b>	<b>%</b>			<b>1.67</b>	<b>%</b>			<b>2.24</b>	<b>%</b>			<b>5.27</b>	<b>%</b>
(1) Equal to OREO operations (losses) gains plus charge-offs, net.															
(2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of OREO divided by average loans and repossessed assets.															
(3) Calculated as net charge-offs plus net loss on OREO operations divided by average loans and repossessed assets.															

## **Operational Risk**

The Corporation faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products. Coupled with external influences such as market conditions, security risks, and legal risk, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and procedures that are designated to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation's business operations are functioning within the policies and limits established by management.

The Corporation classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate-wide risks, such as information security, business recovery, and legal and compliance, the Corporation has specialized groups, such as the Legal Department, Information Security, Corporate Compliance, and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups.

## **Legal and Compliance Risk**

Legal and compliance risk includes the risk of noncompliance with applicable legal and regulatory requirements, the risk of adverse legal judgments against the Corporation, and the risk that a counterparty's performance obligations will be unenforceable. The Corporation is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the last several years. The Corporation has established and continues to enhance procedures based on legal and regulatory requirements that are designed to ensure compliance with all applicable statutory and regulatory requirements. The Corporation has a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of an enterprise-wide compliance risk assessment process. The Compliance division has officer roles in each major business areas with direct reporting relationships to the Corporate Compliance Group.

## **Concentration Risk**

The Corporation conducts its operations in a geographically concentrated area, as its main market is Puerto Rico. However, the Corporation has diversified its geographical risk as evidenced by its operations in the Virgin Islands and in Florida. Of the total gross loans held for investment of \$9.3 billion as of September 30, 2014, approximately 83% have credit risk concentration in Puerto Rico, 10% in the United States and 7% in the Virgin Islands.

**Exposure to Puerto Rico Government**

As of September 30, 2014, the Corporation had \$364.3 million in credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$316.3 million was outstanding, compared to \$397.8 million outstanding as of December 31, 2013. Approximately \$201.4 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of the applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$24.8 million consists of loans to units of the central government, and approximately \$90.1 million consists of loans to public corporations. Furthermore, the Corporation had \$200.4 million outstanding as of September 30, 2014 in financing to the hotel industry in Puerto Rico guaranteed by the TDF.



On June 28, 2014, the governor of Puerto Rico signed into law The Recovery Act to provide a legislative framework for certain public corporations that are experiencing severe financial stress to address their financial obstacles through an orderly, statutory process that allows them to handle their debts, while ensuring the continuity of essential services to citizens and infrastructure upgrades. As of September 30, 2014, the Corporation had an exposure to public corporations covered by the Recovery Act amounting to \$86.1 million, including the \$75 million direct exposure to PREPA. In August 2014, PREPA entered into a forbearance agreement with a group of banks, including FirstBank, to extend further its maturing credit lines to March 31, 2015. As a result of the forbearance, this credit facility was classified as a TDR during the third quarter of 2014. The loan was maintained in accrual status based on the estimated cash flows analysis performed on this noncollateral dependent loan, repayment prospects and compliance with contractual terms.

In addition, as of September 30, 2014, the Corporation had outstanding \$61.1 million in obligations of the Puerto Rico government, mainly bonds of the GDB and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio, carried on its books at a fair value of \$46.4 million. During the first half of 2014, the Corporation sold \$4.6 million of Puerto Rico government agency bonds and received proceeds of \$10 million from matured Puerto Rico government securities. The fair value of the Puerto Rico government obligations held by the Corporation increased by approximately \$4.9 million during the first nine months of 2014.

As of September 30, 2014, the Corporation had \$250.9 million of Puerto Rico public sector deposits (\$228.2 million in transactional accounts and \$22.7 million in time deposits) compared to \$546.5 million as of December 31, 2013. Approximately 57% is from municipalities in Puerto Rico and 43% is from public corporations and the central government and agencies. As mentioned above, certain public corporations and agencies withdrew from FirstBank approximately \$341.6 million during the second quarter of 2014.

### **Impact of Inflation and Changing Prices**

The financial statements and related data presented herein have been prepared in conformity with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a greater impact on a financial institution's performance than the effects of general levels of inflation. Interest rate movements are not necessarily correlated with changes in the prices of goods and services.

### **Basis of Presentation**

Supplemental cash flow information is as follows:

The Corporation has included in this Form 10-Q the following financial measures that are not recognized under generally accepted accounting principles, which are referred to as non-GAAP financial measures: (i) the calculation of net interest income, interest rate spread and net interest margin rate on a tax-equivalent basis and excluding changes in the fair value of derivative instruments; (ii) the calculation of the tangible common equity ratio and the tangible book value per common share; (iii) the Tier 1 common equity to risk-weighted assets ratio; and (iv) certain other financial measures adjusted to exclude the effect of the acquisition of mortgage loans from Doral in 2014 and the bulk sales of assets and the transfer of loans to held for sale in 2013. Investors should be aware that non-GAAP financial measures have inherent limitations and should be read only in conjunction with the Corporation's consolidated financial data prepared in accordance with GAAP.

Net interest income, interest rate spread and net interest margin are reported excluding changes in the fair value of derivative instruments ("valuations") and on a tax-equivalent basis. The presentation of net interest income excluding valuations provides additional information about the Corporation's net interest income and facilitates comparability and analysis. The changes in the fair value of derivative instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively.

The tax-equivalent adjustment to net interest income recognizes the income tax savings when comparing taxable and tax-exempt assets and assumes a marginal income tax rate. Income from tax-exempt earning assets is increased by an amount equivalent to the taxes that would have been paid if this income had been taxable at statutory rates. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. This adjustment puts all earning assets, most notably tax-exempt securities and certain loans, on a common basis that facilitates comparison of results to results of peers. Refer to *Net Interest Income* above for the table that reconciles the non-GAAP financial measure “net interest income on a tax-equivalent basis and excluding fair value changes” with net interest income calculated and presented in accordance with GAAP. The table also reconciles the non-GAAP financial measures “net interest spread and margin on a tax-equivalent basis and excluding fair value changes” with net interest spread and margin calculated and presented in accordance with GAAP.

The tangible common equity ratio and tangible book value per common share are non-GAAP measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible. Tangible assets are total assets less goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase method of accounting for mergers and acquisitions. Neither tangible common equity nor tangible assets, or the related measures should be considered in isolation or as a substitute for stockholders’ equity, total assets, or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Corporation calculates its tangible common equity, tangible assets, and any other related measures may differ from that of other companies reporting measures with similar names. Refer to *Risk Management-Capital* above for a reconciliation of the Corporation’s tangible common equity and tangible assets.

The Tier 1 common equity to risk-weighted assets ratio is calculated by dividing (a) Tier 1 capital less non-common elements including qualifying perpetual preferred stock and qualifying trust preferred securities by (b) risk-weighted assets, which assets are calculated in accordance with current applicable bank regulatory requirements (Basel 1). The Tier 1 common equity ratio is not required by GAAP. Management is currently monitoring this ratio, along with the other ratios discussed above, in evaluating the Corporation’s capital levels and believes that, at this time, the ratio may be of interest to investors. Refer to *Risk Management-Capital* above for a reconciliation of stockholders’ equity (GAAP) to Tier 1 common equity.

To supplement the Corporation’s financial statements presented in accordance with GAAP, the Corporation provides additional measures of provision for loan and lease losses, provision for loan and lease losses to net charge-offs, net charge-offs, and net charge-offs to average loans, that exclude the impact of the mortgage loans acquired from Doral in 2014 and the bulk sales of assets and the transfer of non-performing loans to held for sale in 2013.

Management believes that these non-GAAP measures enhance the ability of analysts and investors to analyze trends in the Corporation’s business and to better understand the performance of the Corporation. In addition, the Corporation may utilize these non-GAAP financial measures as a guide in its budgeting and long-term planning process. Any

Supplemental cash flow information is as follows:

analysis of these non-GAAP financial measures should be used only in conjunction with results presented in accordance with GAAP.

Refer to *Provision and Allowance for Loan and Lease Losses* discussion above for the reconciliation of these non-GAAP financial measures to the GAAP financial measures, except for the reconciliation with respect to the non-GAAP financial measure “provision for loan and lease losses to net charge-offs ratio, excluding the impact of the mortgage loans acquired from Doral and the bulk sales of assets and loans transferred to held for sale” with the provision for loan losses to net charge-offs ratio calculated and presented in accordance with GAAP, which is set forth below:

		<b>Provision for loan and lease losses to Net Charge-Offs</b>					
		<b>(Non-GAAP to GAAP reconciliation)</b>					
		<b>Nine-Month Period Ended</b>					
		<b>September 30, 2014</b>					
		<b>Provision for Loan and Lease Losses</b>			<b>Net Charge-Offs</b>		
Provision for loan and lease losses and net charge-offs,							
excluding special items (Non-GAAP)		\$	84,230			139,174	
Special Items:							
Loss on acquisition of mortgage loans from Doral in full							
satisfaction of secured borrowings owned by Doral to							
FirstBank			1,428			6,908	
Provision for loan and lease losses and net charge-offs							
(GAAP)		\$	85,658		\$	146,082	
Provision for loan and lease losses to net charge-offs,							
excluding special items (Non-GAAP)			60.52%				
Provision for loan and lease losses to net charge-offs							
(GAAP)			58.64%				

		<b>Provision for loan and lease losses to Net Charge-Offs</b>					
		<b>(Non-GAAP to GAAP reconciliation)</b>					
		<b>Nine-Month Period Ended</b>					
		<b>September 30, 2013</b>					
		<b>Provision for Loan and Lease Losses</b>			<b>Net Charge-Offs</b>		
Provision for loan and lease losses and net charge-offs,							
excluding special items (Non-GAAP)		\$	88,780			134,373	
Special Items:							
Bulk sales of assets and loans transferred to held for sale			132,002			232,444	
Provision for loan and lease losses and net charge-offs							
(GAAP)		\$	220,782		\$	366,817	
Provision for loan and lease losses to net charge-offs,							
excluding special items (Non-GAAP)			66.07%				
Provision for loan and lease losses to net charge-offs							
(GAAP)			60.19%				

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For information regarding market risk to which the Corporation is exposed, see the information contained in “Part I – Item 2 -“Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Management.”

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Disclosure Control and Procedures**

First BanCorp’s management, including its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of First BanCorp.’s disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2014. Based on this evaluation, as of the end of the period covered by this Form10-Q, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

#### **Internal Control over Financial Reporting**

There have been no changes to the Corporation’s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Corporation’s internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

In the opinion of the Corporation's management, the pending and threatened legal proceedings of which management is aware will not have a material adverse effect on the financial condition, results of operations or cash flows of the Corporation.

### **ITEM 1A. RISK FACTORS**

The Corporation's business, operating results and/or the market price of our common and preferred stock may be significantly affected by a number of factors. For a detailed discussion of certain risk factors that could affect the Corporation's future operations, financial condition or results for future periods see the risk factor below and in Item 1A, "Risk Factors," in the Corporation's 2013 Annual Report on Form 10-K. These factors could also cause actual results to differ materially from historical results or the results contemplated by the forward-looking statements contained in this report. Also refer to the discussion in "Part I – Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report for additional information that may supplement or update the discussion of risk factors in the Corporation's 2013 Form 10-K.

Additional risks and uncertainties not currently known to the Corporation or currently deemed by the Corporation to be immaterial also may materially adversely affect the Corporation's business, financial condition or results of operations.

***The Corporation's credit quality may be adversely affected by Puerto Rico's current economic condition.***

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, which has endured a prolonged period of economic and fiscal challenges. Based on the first six months of fiscal year 2013-2014, the main economic indicators suggest that the Puerto Rico economy remains weak. According to the Puerto Rico Planning Board, the Commonwealth's gross national product ("GNP") contracted (in real terms) from 2006 through 2011, reflecting its first period of slight economic growth in 2012 and 2013 when GNP grew 0.9% and 0.3%, respectively. For the fiscal years ending June 30, 2014 and 2015, the Puerto Rico Planning Board projects a slight economic growth in real GNP of 0.1% and 0.2%, respectively. This continued period of economic stagnation may have an adverse effect on employment and could have an adverse effect on Commonwealth tax revenues.

Supplemental cash flow information is as follows:



The Government has implemented a multi-year budget plan for reducing the deficit. Some of the measures implemented by the government include increasing corporate taxes and reforming the employee retirement systems of the Commonwealth. Since the government is an important source of employment in Puerto Rico, these measures had a temporary adverse effect on the island's already weak economy. The seasonally adjusted unemployment rate in Puerto Rico decreased to 14.1% in September 2014, compared to 14.6% a year ago. The payroll non-farm employment increased by 0.4% in September 2014, compared to September 2013. On July 1, 2014, the Governor of Puerto Rico signed a balanced budget for fiscal year 2015, the first balanced budget in more than a decade.

The economy of Puerto Rico is highly sensitive to global oil prices since the island does not have a significant mass transit system available to the public and most of its electricity is powered by oil, making it highly vulnerable to fluctuations in oil prices. A substantial increase in the price of oil could adversely impact the economy by reducing disposable income and increasing the operating costs for most businesses and government operations. Consumer spending is particularly sensitive to wide fluctuations in oil prices. Several bills have been filed at the Legislative Assembly that address energy costs in Puerto Rico. One bill supported by the Governor proposes to transform the Telecommunications Regulatory Board into the Energy and Telecommunications Commission, which will be responsible for all energy and telecommunications regulatory matters.

This new entity would also be responsible for all tariff-related issues. Another bill recently approved by the Senate proposes the creation of a regulatory agency that will approve or reject energy rates for all energy producers in Puerto Rico and would be responsible for opening Puerto Rico's energy market to competition. Both proposals are intended to substantially reduce Puerto Rico's energy costs.

The decline in Puerto Rico's economy since 2006 has resulted, among other things, in a decline in our loan originations, an increase in the level of our non-performing assets, loan loss provisions and charge-offs, particularly in our construction and commercial loan portfolios, an increase in the rate of foreclosure loss on mortgage loans, and a reduction in the value of our loan portfolio, all of which have adversely affected our profitability. Any further potential deterioration of economic activity could result in further adverse effects on our profitability.

As of September 30, 2014, the Corporation had \$364.3 million in credit facilities granted to the Puerto Rico government, its municipalities and public corporations, of which \$316.3 million was outstanding, compared to \$397.8 million outstanding as of December 31, 2013. Approximately \$201.4 million of the outstanding credit facilities consists of loans to municipalities in Puerto Rico. Municipal debt exposure is secured by ad valorem taxation without limitation as to rate or amount on all taxable property within the boundaries of each municipality. The good faith, credit, and unlimited taxing power of the applicable municipality have been pledged to the repayment of all outstanding bonds and notes. Approximately \$24.8 million consists of loans to units of the central government, and approximately \$90.1 million consists of loans to public corporations. Furthermore, the Corporation had \$200.4 million outstanding as of September 30, 2014 in financing to the hotel industry in Puerto Rico guaranteed by the TDF.

On June 28, 2014, the governor of Puerto Rico signed into law The Recovery Act to provide a legislative framework for certain public corporations that are experiencing severe financial stress to address their financial obstacles through an orderly, statutory process that allows them to handle their debts, while ensuring the continuity of essential services to citizens and infrastructure upgrades. As of September 30, 2014, the Corporation had an exposure to public corporations covered by the Recovery Act amounting to \$86.1 million, including the \$75 million direct exposure to PREPA. In August 2014, PREPA entered into a forbearance agreement with a group of banks, including FirstBank, to extend further its maturing credit lines to March 31, 2015. As a result of the forbearance, the credit was classified as a TDR loan during the third quarter of 2014. The loan was maintained in accrual status based on the estimated cash flows analysis performed on this noncollateral dependent loan, repayment prospects and compliance with contractual terms.

In addition, as of September 30, 2014, the Corporation had outstanding \$61.1 million in obligations of the Puerto Rico government, mainly bonds of the GDB and the Puerto Rico Building Authority, as part of its available-for-sale investment securities portfolio, carried on its books at a fair value of \$46.4 million.

On February 4, 2014, S&P downgraded the Commonwealth of Puerto Rico's debt to BB+, one level below investment grade. S&P also downgraded to levels below investment grade the credit rating of the GDB and other government

Supplemental cash flow information is as follows:

entities. On February 7, 2014, Moody's downgraded the Commonwealth of Puerto Rico general obligation bonds to Ba2, two notches below investment grade. Moody's also downgraded to Ba2 the Public Building Authority Bonds, the Pension Funding Bonds, the GDB senior notes, the Municipal Finance Authority Bonds, the Puerto Rico Infrastructure Finance Authority Special Tax Revenue Bonds, the Convention Center District Authority Hotel Occupancy Tax Revenue Bonds, the Puerto Rico Highway and Transportation Authority Transportation Revenue Bonds, various ratings of the Puerto Rico Aqueduct and Sewer Authority, and the Puerto Rico Electric Power Authority. In addition, the Puerto Rico Sales Tax Financing Corporation's senior-lien bonds were downgraded by Moody's to Baa1 from A2, retaining investment grade status. Following the downgrades by S&P and Moody's, Fitch became the third agency to downgrade the Commonwealth of Puerto Rico debt to BB, two notches below investment grade.

In July 2014, the Puerto Rico debt and the debt of certain public corporation were downgraded further into speculative grade by these credit agencies after the enactment of The Recovery Act. S&P now rates Puerto Rico's general obligation bonds at BB, two notches below investment grade, Moody's at B2 a highly speculative rate, and Fitch at BB-, three notches below investment grade. The issuers of Puerto Rico government and agencies bonds held by the Corporation have not defaulted, and the contractual payments on these securities have been made as scheduled. On March 11, 2014, the Commonwealth of Puerto Rico sold \$3.5 billion in general obligation bonds at a yield of 8.73% to refinance short-term liabilities and to address liquidity needs.

It is uncertain how the financial markets may react to any potential further rating downgrades of Puerto Rico's debt obligation. However, further deterioration in the fiscal situation, could adversely affect the value of our portfolio of Puerto Rico government and agencies securities.

As of September 30, 2014, the Corporation had \$250.9 million of Puerto Rico public sector deposits (\$228.2 million in transactional accounts and \$22.7 million in time deposits) compared to \$546.5 million as of December 31, 2013. Approximately 57% is from municipalities in Puerto Rico and 43% is from public corporations and the central government and agencies.

In 2014, Act 24-2014 was approved by the Puerto Rico Legislature, seeking to further strengthen the liquidity of the GDB and the GDB's oversight over public funds. Among other measures, Act 24-2014 grants the GDB the ability to exercise additional oversight over certain public funds deposited at private financial institutions and grants the GDB the legal authority, subject to an entity's ability to request waivers under certain specified circumstances, to require such public funds (other than funds of the Legislative Branch, the Judicial Branch, the University of Puerto Rico, governmental pension plans, municipalities and certain other independent agencies) to be deposited at the GDB, which is expected to result in a more efficient management of public resources in an effort to maximize liquidity and efficient use of public resources. As anticipated, certain public corporations and agencies withdrew from FirstBank approximately \$341.6 million during the second quarter of 2014. The Corporation will continue to focus on transactional accounts and capture deposits from entities excluded from Act 24-2014.





**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed with this report, which Exhibit Index is incorporated herein by reference.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Corporation has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized:

	<b>First BanCorp.</b>
	Registrant

Date: November 10, 2014	By:	/s/ Aurelio Alemán
		Aurelio Alemán
		President and Chief Executive Officer

Date: November 10, 2014	By:	/s/ Orlando Berges
		Orlando Berges
		Executive Vice President and Chief Financial Officer



**Exhibit Index**

10.1 – Revised Non-Management Chairman of the Board Compensation Structure.
10.2 – Offer Letter between First BanCorp. and Juan Acosta Reboyras, incorporated by reference from the Form 8-K filed by First BanCorp. On September 3, 2014.
12.1 – Ratio of Earnings to Fixed Charges.
12.2 – Ratio of Earnings to Fixed Charges and Preference Dividends.
31.1 – CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 – CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 – CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 – CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.1 – Interactive Data File with respect to the following materials from the Corporation’s Quarterly Report on Form 10-Q for the period ended September 30, 2014, filed in XBRL (eXtensible Business Reporting Language): (i) the Unaudited Consolidated Statements of Financial Condition, (ii) the Unaudited Consolidated Statements of Income (Loss), (iii) the Unaudited Consolidated Statements of Comprehensive Income (Loss), (iv) the Unaudited Consolidated Statements of Cash Flows, (v) the Unaudited Consolidated Statements of Changes in Stockholders’ Equity, and (vi) Notes to Unaudited Consolidated Financial Statements.



