ALEXANDERS INC
Form 10-Q
August 03, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: **June 30, 2009**

Or

o **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: 001-6064

ALEXANDER S, INC.

(Exact name of registrant as specified in its charter)

Delaware	**51-0100517**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
210 Route 4 East, Paramus, New Jersey	**07652**
(Address of principal executive offices)	(Zip Code)

(212) 587-8541

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes o 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 (Section 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). o Yes o 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.

o Large Accelerated Filer	x Accelerated Filer
o Non-Accelerated Filer (Do not check if smaller reporting company)	o Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

As of June 30, 2009, there were 5,105,936 shares of common stock, par value $1 per share, outstanding.

1

ALEXANDER S, INC.

INDEX

		Page Number
PART I.	**Financial Information**	
Item 1.	Financial Statements:	
	Consolidated Balance Sheets (unaudited) as of June 30, 2009 and December 31, 2008	3
	Consolidated Statement of Operations (unaudited) for the Three and Six Months Ended June 30, 2009 and 2008	4
	Consolidated Statements of Changes in Equity (unaudited) for the Six Months Ended June 30, 2009 and 2008	5
	Consolidated Statements of Cash Flows (unaudited) for the Six Months Ended June 30, 2009 and 2008	6
	Notes to Consolidated Financial Statements (unaudited)	7
	Report of Independent Registered Public Accounting Firm	13
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	22
Item 4.	Controls and Procedures	22
PART II.	**Other Information**	
Item 1.	Legal Proceedings	23
Item 1A.	Risk Factors	23
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	23
Item 3.	Defaults Upon Senior Securities	23
Item 4.	Submission of Matters to a Vote of Security Holders	23
Item 5.	Other Information	24
Item 6.	Exhibits	24
Signatures		25
Exhibit Index		26

PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***
ALEXANDER S, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(Amounts in thousands, except share and per share amounts)

	June 30, 2009	December 31, 2008
ASSETS		
Real estate, at cost:		
Land	$ 74,974	$ 74,974
Buildings, leaseholds and leasehold improvements	818,691	598,114
Construction in progress	109,079	294,887
Total	1,002,744	967,975
Accumulated depreciation and amortization	(121,320)	(114,235)
Real estate, net	881,424	853,740
Cash and cash equivalents	438,669	515,940
Restricted cash	85,752	5,057
Accounts receivable, net of allowance for doubtful accounts of $1,644 and $1,357, respectively	2,932	6,580
Receivable arising from the straight-lining of rents	145,500	137,117
Deferred lease and other property costs, net (including unamortized leasing fees to Vornado of $50,389 and $38,698, respectively)	72,674	61,525
Deferred debt issuance costs, net of accumulated amortization of $13,648 and $13,120, respectively	13,490	12,910
Other assets	12,638	10,699
TOTAL ASSETS	$ 1,653,079	$ 1,603,568
LIABILITIES AND STOCKHOLDERS EQUITY		
Debt	$ 1,249,079	$ 1,221,255
Accounts payable and accrued expenses	55,434	51,192
Amounts due to Vornado	57,516	44,086
Liability for income taxes and other	50,079	48,826
Liability for stock appreciation rights		57,458
TOTAL LIABILITIES	1,412,108	1,422,817
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred stock: $1.00 par value per share; authorized, 3,000,000 shares; issued and outstanding, none		
Common stock: $1.00 par value per share; authorized, 10,000,000 shares; issued, 5,173,450 shares; outstanding 5,105,936 shares and 5,091,590 shares, respectively	5,173	5,173
Additional capital	31,501	30,647
Retained earnings	202,790	143,731
	239,464	179,551
Treasury stock: 67,514 and 81,860 shares, at cost	(375)	(455)
Total Alexander s equity	239,089	179,096
Noncontrolling interest in consolidated subsidiary	1,882	1,655
Total equity	240,971	180,751
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,653,079	$ 1,603,568

See notes to consolidated financial statements.

ALEXANDER S, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(Amounts in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
REVENUES				
Property rentals	$ 37,878	$ 35,413	$ 74,075	$ 71,446
Expense reimbursements	16,997	16,065	33,890	31,798
Total revenues	54,875	51,478	107,965	103,244
EXPENSES				
Operating (including fees to Vornado of $1,288, $1,196, $2,520 and $2,399, respectively)	18,252	17,371	37,287	35,038
General and administrative (including a $21,950 reversal of previously recognized stock appreciation rights (SARs) expense in the three months ended June 30, 2008, and reversals of $34,275 and $21,325 in each six-month period, respectively, and management fees to Vornado of $540 and $1,080 in each three and six-month period)	1,186	(20,519)	(30,498)	(18,673)
Depreciation and amortization	6,841	5,608	12,558	11,209
Total expenses	26,279	2,460	19,347	27,574
OPERATING INCOME	28,596	49,018	88,618	75,670
Interest and other income, net	668	5,607	1,632	10,023
Interest and debt expense	(15,950)	(15,562)	(30,846)	(31,243)
Income before income taxes	13,314	39,063	59,404	54,450
Income tax expense of the taxable REIT subsidiary	(30)	(622)	(118)	(1,124)
Net income	13,284	38,441	59,286	53,326
Net (income) loss attributable to the noncontrolling interest	(279)	13	(227)	280
Net income attributable to Alexander s	$ 13,005	$ 38,454	$ 59,059	$ 53,606
Net income per common share - basic	$ 2.55	$ 7.59	$ 11.58	$ 10.61
Net income per common share - diluted	$ 2.55	$ 7.54	$ 11.57	$ 10.52

See notes to consolidated financial statements.

ALEXANDER S, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(UNAUDITED)

(Amounts in thousands)

	Common Stock	Additional Capital	Retained Earnings	Treasury Stock	Alexander s Equity	Noncontrolling Interest	Total Equity
Balance, December 31, 2007	$ 5,173	$ 27,636	$ 103,014	$ (720)	$ 135,103	$ 2,323	$ 137,426
Net income (loss)			53,606		53,606	(280)	53,326
Distributions						(675)	(675)
Common shares issued under option plan		1,490		127	1,617		1,617
Balance, June 30, 2008	$ 5,173	$ 29,126	$ 156,620	$ (593)	$ 190,326	$ 1,368	$ 191,694
Balance, December 31, 2008	$ 5,173	$ 30,647	$ 143,731	$ (455)	$ 179,096	$ 1,655	$ 180,751
Net income			59,059		59,059	227	59,286
Common shares issued under option plan		854		80	934		934
Balance, June 30, 2009	$ 5,173	$ 31,501	$ 202,790	$ (375)	$ 239,089	$ 1,882	$ 240,971

See notes to consolidated financial statements.

ALEXANDER S, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Amounts in thousands)

	Six Months Ended June 30,	
CASH FLOWS FROM OPERATING ACTIVITIES	**2009**	**2008**
Net income	$ 59,286	$ 53,326
Adjustments to reconcile net income to net cash provided by operating activities:		
Liability for stock appreciation rights	(34,275)	(21,325)
Depreciation and amortization (including amortization of debt issuance costs)	14,019	12,533
Straight-lining of rental income	(8,383)	(5,586)
Other non-cash adjustments	1,884	(1,872)
Change in operating assets and liabilities:		
Accounts receivable, net	3,648	2,831
Other assets	(2,992)	(1,540)
Payment for stock appreciation rights	(22,838)	
FIN 48 income tax liability	1,308	1,277
Accounts payable and accrued expenses	653	(1,950)
Amounts due to Vornado	137	1,815
Other liabilities	(55)	(24)
Net cash provided by operating activities	12,392	39,485
CASH FLOWS FROM INVESTING ACTIVITIES		
Restricted cash	(80,695)	(472)
Construction in progress and real estate additions	(37,585)	(61,654)
Proceeds from the sale of real estate tax abatement certificates		2,986
Net cash used in investing activities	(118,280)	(59,140)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	113,605	55,831
Exercise of stock options	934	1,617
Debt repayments	(85,781)	(7,313)
Debt issuance costs	(141)	
Distributions to the noncontrolling interest		(675)
Net cash provided by financing activities	28,617	49,460
Net (decrease) increase in cash and cash equivalents	(77,271)	29,805
Cash and cash equivalents at beginning of period	515,940	560,231
Cash and cash equivalents at end of period	$ 438,669	$ 590,036
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash payments for interest (of which $2,763 and $4,877 have been capitalized)	$ 29,610	$ 33,721
Cash payments for income taxes	$ 107	$ 1,820

See notes to consolidated financial statements.

6

ALEXANDER S, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Organization

Alexander s, Inc. (NYSE: ALX) is a real estate investment trust (REIT), incorporated in Delaware, engaged in leasing, managing, developing and redeveloping its properties. All references to we, us, our, or Company refer to Alexander s, Inc. and its consolidated subsidiaries. We are managed by, and our properties are leased and developed by, Vornado Realty Trust (Vornado) (NYSE: VNO).

2. Basis of Presentation

The accompanying consolidated financial statements are unaudited. In our opinion, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows have been made. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted in accordance with Article 10 of Regulation S-X and the instructions to Form 10-Q. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of the operating results for the full year.

The accompanying consolidated financial statements include our accounts and those of our consolidated subsidiaries. All significant intercompany amounts have been eliminated. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Certain prior year balances have been reclassified in order to conform to current year presentation as a result of the adoption of Financial Accounting Standards Board (FASB) Statement No. 160*, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (SFAS 160).

We currently operate in one business segment.

3. Recently Issued Accounting Literature

In December 2007, the FASB issued Statement No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R broadens the guidance of SFAS 141, extending its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It also broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations; and acquisition related costs will generally be expensed rather than included as part of the basis of the acquisition. SFAS 141R

expands required disclosures to improve the ability to evaluate the nature and financial effects of business combinations. SFAS 141R became effective for all transactions entered into, on or after January 1, 2009. The adoption of SFAS 141R on January 1, 2009, did not have any effect on our consolidated financial statements.

In December 2007, the FASB issued SFAS 160. SFAS 160 requires a noncontrolling interest in a subsidiary to be reported as equity and the amount of consolidated net income specifically attributable to the noncontrolling interest to be identified in the consolidated financial statements. SFAS 160 also calls for consistency in the manner of reporting changes in the parent s ownership interest and requires fair value measurement of any noncontrolling equity investment retained in a deconsolidation. SFAS 160 became effective on January 1, 2009. The adoption of SFAS 160 on January 1, 2009, resulted in (i) the reclassification of our minority interest in consolidated subsidiary to noncontrolling interest in consolidated subsidiary, a component of permanent equity on our consolidated balance sheets, and (ii) the reclassification of minority interest expense to net income attributable to the noncontrolling interest on our consolidated statements of operations.

ALEXANDER S, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

3. Recently Issued Accounting Literature - continued

On May 28, 2009, the FASB issued Statement No. 165, *Subsequent Events* (SFAS 165). Although SFAS 165 does not significantly change current practice surrounding the disclosure of subsequent events, it provides guidance on management s assessment of subsequent events and the requirement to disclose the date through which subsequent events have been evaluated. SFAS 165 became effective on June 30, 2009. We have evaluated subsequent events through August 2, 2009 for this quarterly report on Form 10-Q for the quarter ended June 30, 2009.

On June 12, 2009, the FASB issued Statement No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167). SFAS 167 modifies the existing quantitative guidance used in determining the primary beneficiary of a variable interest entity (VIE) by requiring entities to qualitatively assess whether an enterprise is a primary beneficiary, based on whether the entity has (i) power over the significant activities of the VIE, and (ii) an obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. SFAS 167 becomes effective for all new and existing VIEs on January 1, 2010. The adoption of SFAS 167 will not have a material affect on our consolidated financial statements.

On June 29, 2009, the FASB issued Statement No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles A Replacement of FASB Statement No. 162* (SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification (the Codification) as the primary source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC are also sources of authoritative GAAP for SEC registrants. SFAS 168 and the Codification become effective on September 30, 2009. When effective, the Codification will supersede all existing non-SEC accounting and reporting standards and the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, the FASB will issue Accounting Standards Updates, which will serve only to: (a) update the Codification; (b) provide background information about the guidance; and (c) provide the basis for conclusions on the change(s) in the Codification. The adoption of SFAS 168 and the Codification on September 30, 2009 will not have a material effect on our consolidated financial statements.

4. Relationship with Vornado

At June 30, 2009, Vornado owned 32.4% of our outstanding common stock. We are managed by, and our properties are leased and developed by, Vornado, pursuant to the agreements described below, which expire in March of each year and are automatically renewable.

Management and Development Agreements

We pay Vornado an annual management fee equal to the sum of (i) $3,000,000, (ii) 3% of gross income from the Kings Plaza Regional Shopping Center, (iii) $0.50 per square foot of the tenant-occupied office and retail space at 731 Lexington Avenue and (iv) $241,000, escalating at 3% per annum, for managing the common area of 731 Lexington Avenue.

In addition, Vornado is entitled to a development fee of 6% of development costs, as defined, with minimum guaranteed fees of $750,000 per annum. The development fee for the Rego Park II project (see Note 5) is estimated to be approximately $17,500,000, of which $2,996,000 has been paid as of June 30, 2009. The balance is due on substantial completion of the construction.

Leasing Agreements

Vornado also provides us with leasing services for a fee of 3% of rent for the first ten years of a lease term, 2% of rent for the eleventh through the twentieth year of a lease term, and 1% of rent for the twenty-first through thirtieth year of a lease term, subject to the payment of rents by tenants. In the event third-party real estate brokers are used, the fees to Vornado increase by 1% and Vornado is responsible for the fees to the third-party real estate brokers. Vornado is also entitled to a commission upon the sale of any of our assets equal to 3% of gross proceeds, as defined, for asset sales less than $50,000,000 and 1% of gross proceeds, as defined, for asset sales of $50,000,000 or more. The total of these amounts is payable in annual installments in an amount not to exceed $4,000,000, with interest on the unpaid balance at one-year LIBOR plus 1.0% (3.02% at June 30, 2009).

ALEXANDER S, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

4. Relationship with Vornado - continued

Other Agreements

We have also entered into agreements with Building Maintenance Services, a wholly owned subsidiary of Vornado, to supervise cleaning, engineering and security services at our Lexington Avenue and Kings Plaza properties for an annual fee of the cost for such services plus 6%.

The following is a summary of fees to Vornado that were incurred under the agreements discussed above.

(Amounts in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Company management fees	$ 750	$ 750	$ 1,500	$ 1,500
Development fees	916	1,887	2,149	3,150
Leasing fees	13,805	471	14,289	1,104
Property management fees and payments for cleaning, engineering and security services	1,078	986	2,100	1,979
	$ 16,549	$ 4,094	$ 20,038	$ 7,733

At June 30, 2009, we owed Vornado $42,867,000 for leasing fees, $13,266,000 for the earned portion of the Rego II development fee discussed above, and $1,383,000 for management, property management and cleaning fees.

5. Rego Park II Project

We own approximately 6.6 acres of land adjacent to our Rego Park I property in Queens, New York, which comprises the entire square block bounded by the Horace Harding Service Road (of the Long Island Expressway), 97th Street, 62nd Drive and Junction Boulevard. The development at Rego Park II consists of a 600,000 square foot shopping center on four levels and a parking deck containing approximately 1,400 spaces. Construction is expected to be substantially completed by the end of this year and estimated to cost approximately $410,000,000, of which $332,532,000 has been expended as of June 30, 2009. As of June 30, 2009, we have leased 138,000 square feet to Home Depot, 134,000 square feet to Century 21 department store, and 132,000 square feet to Kohl s, (collectively, the anchor tenants). During the quarter ended June 30, 2009, we tendered possession to our anchor tenants and and placed that portion of the asset into service; accordingly we transferred approximately $222,000,000 from Construction in progress to Buildings, leaseholds and leasehold improvements. There can be no assurance that the balance of the project will be completed, completed on time, or completed for the budgeted amount.

6. 731 Lexington Avenue

On March 25, 2009, Citibank N.A. completed the assignment of its lease aggregating 176,000 square feet to Bloomberg L.P., which now occupies all of the office space at this property.

7. Flushing

In February 2009, we sub-leased the Flushing property to a developer for the remainder of our ground lease term.

ALEXANDER S, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

8. Debt

The following is a summary of our outstanding debt.

(Amounts in thousands)	Maturity	Interest Rate at June 30, 2009	Balance at June 30, 2009		December 31, 2008
$350,000 construction loan, secured by the Rego Park II Shopping Center [1]	Dec. 2010	1.52%	$ 217,054		$ 181,695
First mortgage, secured by the Paramus property	Oct. 2011	5.92%	68,000		68,000
First mortgage, secured by the Kings Plaza Regional Shopping Center	Jun. 2011	7.46%	197,422		199,537
First mortgage, secured by the Rego Park I Shopping Center	Mar. 2012	0.75%	78,246	(2)	78,386
First mortgage, secured by the office space at the Lexington Avenue property	Feb. 2014	5.33%	368,357		373,637
First mortgage, secured by the retail space at the Lexington Avenue property [3]	Jul. 2015	4.93%	320,000		320,000
			$ 1,249,079		$ 1,221,255

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(1) This loan bears interest at LIBOR plus 1.20% and has a one-year extension option.

(2) On March 10, 2009, we repaid the $78,246 outstanding balance of the Rego Park I mortgage loan which was scheduled to mature in June 2009 and simultaneously completed a refinancing in the same amount. The new loan bears interest at 75 basis points, is secured by the property and is 100% cash collateralized. The proceeds of the new loan were placed in a non-interest bearing restricted mortgage escrow account. The loan is prepayable at any time without penalty.

(3) In the event of a substantial casualty, as defined, up to $75,000 of this loan may become recourse to us.

The fair value of our consolidated debt is calculated by discounting the future contractual cash flows of our existing debt using the current rates available to borrowers with similar credit ratings for the remaining terms of such debt. As of June 30, 2009, and December 31, 2008, the estimated fair value of our consolidated debt was less then its carrying amount by approximately $175,813,000 and $118,485,000, respectively. Such fair value estimates are not necessarily indicative of the amounts that would be realized upon disposition of our financial instruments.

9. FIN 48 Income Tax Liability

As of June 30, 2009 and December 31, 2008, we had $49,176,000 and $47,868,000, respectively, of unrecognized tax benefits that if recognized, would result in non-cash income and reduce our effective tax rate. These amounts, which include $11,195,000 and $9,888,000 of accrued interest as of June 30, 2009 and December 31, 2008, respectively, are included as a component of liability for income taxes and other on our consolidated balance sheets.

We recognize interest related to the unrecognized tax benefits in interest and debt expense in our consolidated statements of operations. In the three months ended June 30, 2009 and 2008, we recognized $659,000 and $643,000, respectively, and in the six months ended June 30, 2009 and 2008, we recognized $1,308,000 and $1,277,000, respectively, of interest related to the unrecognized tax benefits.

As of June 30, 2009, Taxable REIT Subsidiary (TRS) tax returns for the years 2003 through 2008 and REIT tax returns for the years 2006 through 2008 remain open to examination by the major taxing jurisdictions to which we are subject.

ALEXANDER S, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

10. Stock Appreciation Rights

Stock appreciation rights (SARs) are granted at 100% of the market price of our common stock on the date of grant. Compensation expense for each SAR is measured by the excess of stock price at the current balance sheet date over the stock price at the previous balance sheet date. If the stock price is lower at the current balance sheet date, previously recognized expense is reversed but not below zero. On March 2, 2009, Steven Roth, the Chairman of our Board of Directors and Chief Executive Officer and Michael Fascitelli, our President, each exercised 150,000 SARs, which were scheduled to expire on March 4, 2009. Mr. Roth and Mr. Fascitelli each received gross proceeds of $11,419,000. As a result of the March 2, 2009 exercises, we reversed $34,275,000 of previously recognized SARs compensation expense in the six months ended June 30, 2009. As of June 30, 2009, there are no SARs outstanding. In the three and six months ended June 30, 2008, we reversed $21,950,000 and $21,325,000, respectively, of previously recognized expense, based on our closing stock price of $310.60 at June 30, 2008, compared to $354.50 at March 31, 2008 and $353.25 at December 31, 2007.

11. Commitments and Contingencies

Insurance

We carry commercial liability with limits of $200,000,000 per location and all risk property insurance for (i) fire, (ii) flood, (iii) rental loss, (iv) extended coverage, and (v) acts of terrorism, as defined in the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) of 2007, with respect to our assets, with limits of $1.7 billion per occurrence for all of our properties. To the extent that we incur losses in excess of our insurance coverage, these losses would be borne by us and could be material.

Our debt instruments, consisting of mortgage loans secured by our properties (which are generally non-recourse to us), contain customary covenants requiring us to maintain insurance. Although we believe that we have adequate insurance coverage for the purposes of these agreements, we may not be able to obtain an equivalent amount of coverage at reasonable costs in the future. Further, if lenders insist on greater coverage than we are able to obtain, it could adversely affect our ability to finance and/or refinance our properties.

Environmental Remediation

In July 2006, we discovered an oil spill at our Kings Plaza Regional Shopping Center. We have notified the New York State Department of Environmental Conservation (NYSDEC) about the spill and have developed a remediation plan. The NYSDEC has approved a portion of the remediation plan and clean up is ongoing. The estimated costs associated with the clean up will aggregate approximately $2,500,000. We have paid $500,000 of such amount and the remainder is covered under our insurance policy.

Flushing Property

In the fourth quarter of 2003, we recognized $1,289,000 of income representing a non-refundable deposit of $1,875,000, net of $586,000 of costs associated with the transaction, from a party that had agreed to purchase this property, as such party had not met its obligations under a May 30, 2002 purchase contract. On September 10, 2002, November 7, 2002, and July 8, 2004, we received letters from the party demanding return of the deposit. On December 28, 2005, the party filed a complaint against us in the Supreme Court of the State of New York alleging that we failed to honor the terms and conditions of the agreement. The complaint seeks specific performance and, if specific performance is denied, it seeks the return of the deposit plus interest and $50,000 in costs. In our opinion, after consultation with legal counsel, we do not believe the party is entitled to either specific performance or a return of the deposit and we are defending against the action. Accordingly, we have not recorded a loss contingency for this matter.

ALEXANDER S, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

11. Commitments and Contingencies continued

Paramus

In 2001 we leased 30.3 acres of land located in Paramus, New Jersey to IKEA Property, Inc. The lease has a 40-year term with a purchase option in 2021 for $75,000,000. We have a $68,000,000 interest only, non-recourse mortgage loan on the property from a third party lender. The fixed interest rate on the loan is 5.92% with interest payable monthly until maturity in October 2011. The annual triple-net rent is the sum of $700,000 plus the amount of debt service on the mortgage loan. If the purchase option is exercised, we will receive net cash proceeds of approximately $7,000,000 and recognize a gain on sale of land of approximately $62,000,000. If the purchase option is not exercised, the triple-net rent for the last 20 years must include the debt service sufficient to fully amortize $68,000,000 over the remaining 20-year lease term.

Letters of Credit

At June 30, 2009, we had approximately $7,998,000 of standby letters of credit th: 6pt">

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.

During the second quarter of 2009, the Corporation recorded OTTI losses on available-for-sale debt securities as follows:

(In thousands)		**Private label MBS**
Total other-than-temporary impairment losses	$	(32,541)
Unrealized other-than-temporary impairment losses recognized in OCI (1)		31,480
Net impairment losses recognized in earnings (2)	$	(1,061)

(1) Represents the noncredit component impact of the OTTI on available-for-sale debt securities

(2) Represents the credit component of the OTTI on available-for-sale debt securities

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:

(In thousands)	**Quarter Ended June 30, 2009**
Credit losses at the beginning of the period	$
Additions:	
Credit losses related to securities for which an OTTI was not previously recognized	1,061
Ending balance of credit losses on debt securities held for which a portion of an OTTI was recognized in OCI	$ 1,061

As of June 30, 2009, debt securities with OTTI, for which a loss related to credit was recognized in earnings, consisted entirely of private label MBS. Private label MBS are mortgage pass-through certificates bought from R&G Financial Corporation (R&G Financial), a Puerto Rican financial institution. During the second quarter of 2009, the Corporation received from R&G Financial a payment of $4.2 million to eliminate the 10% recourse provision contained in the private label MBS. The elimination of the recourse provision was the reason for which the present value of the expected future cash flows in these private label MBS is less than the amortized cost of the security.

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States and the interest rate 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. 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.

Table of Contents

loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, 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, others) to provide an estimate of default and loss severity.

For valuation purposes, the Corporation used a discounted cash flow model applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread bias on a non-rated security and utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. 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 as of June 30, 2009.

	Weighted Average	**Range**	
Discount rate	15%	15%	
Prepayment rate	23%	15.90%	39.40%
Projected Cumulative Loss Rate	4%	0.39%	8.90%

For the six-month periods ended on June 30, 2009 and 2008, the Corporation recorded OTTI of approximately $0.4 million and $0.5 million, respectively, on certain equity securities held in its available-for-sale investment portfolio related to financial institutions in Puerto Rico. Management concluded that the declines in value of the securities were other-than-temporary; as such, the cost basis of these securities was written down to the market value as of the date of the analysis and is reflected in earnings as a realized loss.

Total proceeds from the sale of securities available for sale during the first half of 2009 amounted to approximately $791.3 million (2008 $389.8 million). The following table summarizes the realized gains and losses on sales of securities available for sale for the periods indicated:

	Quarter Ended June 30,		**Six-Month Period Ended June 30,**	
(In thousands)	**2009**	**2008**	**2009**	**2008**
Realized gains	$ 10,305	$	$ 28,143	$ 6,851
Realized losses		(190)		(190)
Net realized security gains (losses)	$ 10,305	$ (190)	$ 28,143	$ 6,661

22

Table of Contents

5 OTHER EQUITY SECURITIES

Institutions that are members of the FHLB system are required to maintain a minimum investment in FHLB stock. Such minimum 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 June 30, 2009 and December 31, 2008, the Corporation had investments in FHLB stock with a book value of $81.9 million and $62.6 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for the second quarter and six-month period ended June 30, 2009 amounted to $0.8 million and $1.1 million, respectively, compared to $1.1 million and $2.3 million, respectively, for the same periods in 2008.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of June 30, 2009 and December 31, 2008 was $1.6 million. During the first quarter of 2008, the Corporation realized a one-time gain of $9.3 million on the mandatory redemption of part of its investment in VISA, Inc., which completed its initial public offering (IPO) in March 2008.

6 LOAN PORTFOLIO

The following is a detail of the loan portfolio:

	As of June 30, 2009	As of December 31, 2008
	(In thousands)	
Residential real estate loans, mainly secured by first mortgages	$ 3,621,496	$ 3,481,325
Commercial loans:		
Construction loans	1,580,207	1,526,995
Commercial mortgage loans	1,564,933	1,535,758
Commercial loans	4,002,306	3,857,728
Loans to local financial institutions collaterilized by real estate mortgages	336,300	567,720
Commercial loans	7,483,746	7,488,201
Finance leases	341,119	363,883
Consumer loans	1,656,410	1,744,480
Loans receivable	13,102,771	13,077,889
Allowance for loan and lease losses	(407,746)	(281,526)
Loans receivable, net	12,695,025	12,796,363
Loans held for sale	32,939	10,403

Total loans	$ 12,727,964	$ 12,806,766

Table of Contents

The Corporation s primary lending area is Puerto Rico. The Corporation s Puerto Rico banking subsidiary (FirstBank or the Bank) also lends in the U.S. and British Virgin Islands markets and in the United States (principally in the state of Florida). Of the total gross loan portfolio, including loans held for sale, of $13.1 billion as of June 30, 2009, approximately 81% has regional credit risk concentration in Puerto Rico, 11% in the United States (mainly in the state of Florida) and 8% in the Virgin Islands.

The Corporation s largest loan concentration to one borrower of $336.3 million as of June 30, 2009 is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual mortgage loans on residential and commercial real estate. During the second quarter of 2009, the Corporation completed a transaction with R&G Financial that involved the purchase of approximately $205 million of residential mortgage loans that previously served as collateral for a commercial loan extended to R&G Financial. The purchase price of the transaction was retained by the Corporation to fully pay off the loan, thereby significantly reducing the Corporation s exposure to a single borrower. Also, a $500 million facility extended in the first quarter of 2009 to the Puerto Rico Sales Tax Financing Corp. (COFINA under its Spanish acronym), an instrumentality of the Government of Puerto Rico, was paid off on June 18, 2009.

7 ALLOWANCE FOR LOAN AND LEASE LOSSES

The changes in the allowance for loan and lease losses were as follows:

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Balance at beginning of period	$ 302,531	$ 210,495	$ 281,526	$ 190,168
Provision for loan and lease losses	235,152	41,323	294,581	87,116
Charge-offs	(131,375)	(31,602)	(173,835)	(58,988)
Recoveries	1,438	2,056	5,474	3,976
Balance at end of period	$ 407,746	$ 222,272	$ 407,746	$ 222,272

The allowance for impaired loans is part of the allowance for loan and lease losses. The allowance for impaired loans covers those loans for which management has determined that it is probable that the debtor will be unable to pay all the amounts due in accordance with the contractual terms of the loan agreement, and does not necessarily represent loans for which the Corporation will incur a loss. As of June 30, 2009 and December 31, 2008, impaired loans and their related allowance were as follows:

	As of June 30, 2009	As of December 31, 2008
	(In thousands)	
Impaired loans with valuation allowance, net of charge-offs	$ 647,390	$ 384,914
Impaired loans without valuation allowance, net of charge-offs	288,199	116,315
Total impaired loans	$ 935,589	$ 501,229
Allowance for impaired loans	$ 117,526	$ 83,353

Table of Contents

The loans that were classified as impaired during the first half of 2009, totaled approximately $614.0 million ($368.3 million pertained to Florida operations). These loans required a specific reserve of $83.9 million. Partially offsetting the increase in impaired loans were charge-offs of approximately $26.5 million related to the $614 million of loans classified as impaired during 2009 and approximately $93.3 million associated with impaired loans identified prior to 2009 and other decreases, including loans paid in full, partial payments and collateral repossessions, mainly in Florida. During the first half of 2009, the Corporation repossessed approximately $9.2 million of commercial real estate properties in Florida, net of charge-offs of approximately $8.2 million.

Approximately $64.7 million, or 54%, of the charge-offs recorded during 2009 are related to the construction loan portfolio in Florida and $26.3 million, or 22%, are related to the construction loan portfolio in Puerto Rico.

The following table sets forth an analysis of the activity in the allowance for impaired loans for the six-month period ended June 30, 2009:

	For the Six-Month Period Ended June 30, 2009				
	Construction Loans	Commercial Loans	Commercial Mortgage Loans	Other Loans (1)	Total
Allowance for impaired loans, beginning of period	$ 56,330	$ 18,343	$ 8,680	$	$ 83,353
Provision for impaired loans	113,185	19,463	17,796	3,571	154,015
Charge-offs	(91,060)	(14,946)	(13,836)		(119,842)
Allowance for impaired loans, end of period	$ 78,455	$ 22,860	$ 12,640	$ 3,571	$ 117,526

(1) Mainly related to restructured residential mortgage loans.

Interest income in the amount of approximately $5.4 million and $9.8 million was recognized on impaired loans for the second quarter and first half of 2009, respectively, compared to $2.2 million and $7.9 million, respectively, for the same periods in 2008. The average recorded investment in impaired loans for the first six-months of 2009 and 2008 was $693.4 million and $205.8 million, respectively.

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico. Due to the nature of the borrower s financial condition, the restructure or loan modification through this program as well as other individual commercial, commercial mortgage loans, construction loans and residential mortgages in the U.S. mainland fits the definition of Troubled Debt Restructuring (TDR) as defined by SFAS 15, Accounting by Debtors and Creditors of Troubled Debt Restructurings. Such restructures are identified as TDRs and accounted for based on the provisions SFAS 114, Accounting by Creditors for Impairment of a Loan. As of June 30, 2009, the Corporation s TDR loans consisted of $56.9 million of residential mortgage loans, $25.1 million commercial loans, $44.5 million commercial mortgage loans and $104.0 million of construction loans.

Table of Contents

8 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 change in response to 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 uses various financial instruments, including derivatives, to manage the interest rate risk primarily to the value of its medium-term notes and for protection of rising interest rates in connection with private label MBS.

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 June 30, 2009 and December 31, 2008, 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 most of the 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 against rising interest rates. Specifically, the interest rate on certain private label mortgage pass-through securities and certain of the Corporation s commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the pass-through certificate or referenced residential mortgage collateral, less a contractual servicing fee.

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 June 30, 2009, most of the interest rate swaps outstanding are used for protection against rising interest rates. In the past, interest rate swaps volume was much higher since they were used to convert fixed-rate brokered CDs (liabilities), mainly those with long-term maturities, to a variable rate and mitigate the interest rate risk inherent in variable rate loans. However, most of these interest rate swaps were called during 2009, in the face of lower interest rate levels, and as a consequence the Corporation exercised its call option on the swapped-to-floating brokered CDs. 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.

Table of Contents

Indexed options Indexed options are generally over-the-counter (OTC) contracts that the Corporation enters into in order to receive the appreciation of a specified Stock Index (e.g., Dow Jones Industrial Composite Stock Index) over a specified period in exchange for a premium paid at the contract s inception. The option period is determined by the contractual maturity of the notes payable tied to the performance of the Stock Index. The credit risk inherent in these options is the risk that the exchange party may not fulfill its obligation.

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

In addition, the Corporation enters 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 as of June 30, 2009 and December 31, 2008:

	Notional Amounts	
	As of June 30, 2009	As of December 31, 2008
	(In thousands)	
Economic undesignated hedges:		
Interest rate contracts:		
Interest rate swap agreements used to hedge fixed-rate brokered certificates of deposits, notes payable and loans	$ 80,577	$ 1,184,820
Written interest rate cap agreements	197,955	128,043
Purchase interest rate cap agreements	335,114	276,400
Equity contracts:		
Embedded written options on stock index deposits and notes payable	53,515	53,515
Purchased options used to manage exposure to the stock market on embedded stock index options	53,515	53,515
	$ 720,676	$ 1,696,293

Table of Contents

The following table summarizes the fair values of derivative instruments and the location in the Statement of Financial Condition as of June 30, 2009 and December 31, 2008:

	Asset Derivatives			Liability Derivatives		
		As of June 30, 2009	As of December 31, 2008		As of June 30, 2009	As of December 31, 2008
	Statement of Financial Condition Location	Fair Value	Fair Value	Statement of Financial Condition Location	Fair Value	Fair Value
	(Dollars in thousands)					
Economic undesignated hedges:						
Interest rate contracts:						
Interest rate swap agreements used to hedge fixed-rate brokered CDs, notes payable and loans	Other Assets	$ 326	$ 5,649	Accounts payable and other liabilities	$ 5,708	$ 7,188
Written interest rate cap agreements	Other Assets			Accounts payable and other liabilities	428	3
Purchase interest rate cap agreements	Other Assets	4,004	764	Accounts payable and other liabilities		
Equity contracts:						
Embedded written options on stock index deposits	Other Assets			Interest bearing deposits	23	241
Embedded written options on stock index notes payable	Other Assets			Notes payable	510	1,073
Purchased options used to manage exposure to the stock market on embedded stock index options	Other Assets	568	1,597	Accounts payable and other liabilities		
		$ 4,898	$ 8,010		$ 6,669	$ 8,505

The following table summarizes the effect of derivative instruments on the Statement of Income for the quarters and six-month periods ended on June 30, 2009 and 2008:

	Location of Unrealized Gain or (loss) Recognized in Income on Derivatives	Unrealized Gain or (Loss) Quarter Ended June 30,		Unrealized Gain or (Loss) Six-Month Period Ended June 30,	
		2009	2008	2009	2008
		(In thousands)		(In thousands)	
Interest rate contracts:					
Interest rate swap agreements used to hedge:					
Brokered CDs	Interest Expense on Deposit	$ (877)	$ (29,805)	$ (5,236)	$ 25,552
Notes payable	Interest Expense on Notes Payable and Other Borrowings		(247)	3	(114)
Loans	Interest Income on Loans	837	2,548	1,390	40
Written and purchased interest rate cap agreements - mortgage-backed securities	Interest Income on Investment Securities	2,489	3,041	2,706	857
Written and purchased interest rate cap agreements loans	Interest Income on Loans	139	54	144	23
Equity contracts:					
Embedded written and purchased options on stock index deposits	Interest Expense on Deposits	(15)	(129)	(82)	(150)
Embedded written and purchased options on stock index notes payable	Interest Expense on Notes Payable and Other Borrowings	(53)	(67)	(166)	113
Total Unrealized Gain (Loss) on derivatives		$ 2,520	$ (24,605)	$ (1,241)	$ 26,321

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. The unrealized gains and losses in the fair value of derivatives that economically hedge certain callable brokered CDs and medium-term notes are partially offset by unrealized gains and losses on the valuation of such economically hedged liabilities that were elected to be measured at fair value under the provisions of SFAS 159. The Corporation includes the gain or loss on those economically hedged liabilities (brokered CDs and medium-term notes) in the same line item as the offsetting loss or gain on the related derivatives as set forth below:

Table of Contents

	Quarter ended June 30,					
	2009			2008		
(In thousands)	Loss on Derivatives	Gain / (Loss) on SFAS 159 liabilities	Net Unrealized Gain / (Loss)	Loss on Derivatives	Gain on SFAS 159 liabilities	Net Unrealized Loss
Interest expense on Deposits	$(892)	$ 1,555	$ 663	$(29,934)	$ 28,462	$ (1,472)
Interest expense on Notes Payable and Other Borrowings	(53)	(1,679)	(1,732)	(314)	2	(312)

	Six-Month Period ended June 30,					
	2009			2008		
(In thousands)	Loss on Derivatives	Gain / (Loss) on SFAS 159 liabilities	Net Unrealized Gain / (Loss)	Gain / (Loss) on Derivatives	(Loss) / Gain on SFAS 159 liabilities	Net Unrealized Gain
Interest expense on Deposits	$(5,318)	$ 8,696	$ 3,378	25,402	(21,095)	$ 4,307
Interest expense on Notes Payable and Other Borrowings	(163)	(1,424)	(1,587)	(1)	899	898

A summary of interest rate swaps as of June 30, 2009 and December 31, 2008 follows:

	As of June 30, 2009	As of December 31, 2008
	(Dollars in thousands)	
Pay fixed/receive floating:		
Notional amount	$80,577	$ 78,855
Weighted-average receive rate at period end	2.24%	3.21%
Weighted-average pay rate at period end	6.52%	6.75%
Floating rates range from 167 to 252 basis points over 3-month LIBOR		
Receive fixed/pay floating (generally used to economically hedge fixed-rate brokered CDs and notes payable):		
Notional amount	$	$1,105,965
Weighted-average receive rate at period end	0.00%	5.30%
Weighted-average pay rate at period end	0.00%	3.09%

During the first half of 2009, all of the $1.1 billion of interest rate swaps that economically hedge brokered CDs were called by the counterparties, mainly due to lower levels of 3-month LIBOR. Following the cancellation of the interest rate swaps, the Corporation exercised its call option on the approximately $1.1 billion swapped-to- floating brokered CDs. The Corporation recorded a net loss of $3.5 million as a result of these transactions resulting from the reversal of the cumulative mark-to-market valuation of the swaps and the brokered CDs called.

As of June 30, 2009, the Corporation has not entered into any derivative instrument containing credit-risk-related contingent features.

Table of Contents

9 GOODWILL AND OTHER INTANGIBLES

Goodwill as of June 30, 2009 and December 31, 2008 amounted to $28.1 million recognized as part of Other Assets. The goodwill resulted primarily from the acquisition of Ponce General Corporation in 2005. No goodwill impairment was recognized during 2009 and 2008. Goodwill is reviewed for impairment at least annually. Goodwill impairment analysis will be conducted during the second half of 2009.

As of June 30, 2009, the gross carrying amount and accumulated amortization of core deposit intangibles was $41.8 million and $23.7 million, respectively, recognized as part of Other Assets in the Consolidated Statements of Financial Condition (December 31, 2008 $45.8 million and $21.8 million, respectively). During the quarter and six-month period ended June 30, 2009, the amortization expense of core deposits amounted to $0.9 million and $1.9 million, respectively, compared to $0.9 million and $1.7 million, respectively, for the comparable periods in 2008. As a result of an impairment evaluation on core deposit intangibles, in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, there was an impairment charge of $4.0 million recognized during the first half of 2009 related to core deposits in FirstBank Florida attributable to decreases in the base of core deposits acquired.

10 DEPOSITS

The following table summarizes deposit balances:

	As of June 30, 2009	As of December 31, 2008
	(In thosands)	
Non-interest bearing checking account deposits	$ 718,370	$ 625,928
Savings accounts	1,479,795	1,288,179
Interest-bearing checking accounts	881,868	726,731
Certificates of deposits	1,719,229	1,986,770
Brokered certificates of deposits (includes $0 and $1,150,959 measured at fair value as of June 30, 2009 and December 31, 2008, respectively)	7,236,165	8,429,822
	$ 12,035,427	$ 13,057,430

The interest expense on deposits includes the market valuation of interest rate swaps that economically hedge brokered CDs, the related interest exchanged, the amortization of broker placement fees related to brokered CDs not elected for the fair value option and changes in fair value of callable brokered CDs elected for the fair value option under SFAS 159 (SFAS 159 brokered CDs).

30

Table of Contents

The following are the components of interest expense on deposits:

	Quarter Ended		Six-Month Period Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
	(In thousands)		(In thousands)	
Interest expense on deposits	$ 75,058	$ 94,039	$ 166,000	$ 203,192
Amortization of broker placement fees (1)	5,063	4,256	12,146	7,079
Interest expense on deposits excluding net unrealized (gain) loss on derivatives and SFAS 159 brokered CDs	80,121	98,295	178,146	210,271
Net unrealized (gain) loss on derivatives and SFAS 159 brokered CDs	(663)	1,472	(3,378)	(4,307)
Total interest expense on deposits	$ 79,458	$ 99,767	$ 174,768	$ 205,964

(1) Related to brokered CDs not elected for the fair value option under SFAS 159.

Total interest expense on deposits includes net cash settlements on interest rate swaps that economically hedge brokered CDs that for the quarter and six-month period ended June 30, 2009 amounted to net interest realized of $0.8 million and $5.5 million, respectively, compared to $12.9 million and $19.9 million, respectively, for the comparable periods in 2008. As of June 30, 2009, there were no interest rate swap agreements outstanding that hedge brokered CDs since all of them were called by the counterparties during 2009. Refer to Note 8 for additional information.

11 LOANS PAYABLE

As of June 30, 2009, loans payable consisted of $135 million in short-term borrowings under the FED Discount Window Program bearing interest at 0.50%. In the first quarter of 2009, the Corporation received approval to participate in the Borrower-in-Custody (BIC) Program of the FED. Through the BIC Program, a broad range of loans (including commercial, consumer and mortgages) may be pledged as collateral for borrowings through the FED Discount Window. As of June 30, 2009, the Corporation had an unused capacity of approximately $514 million on this credit facility based on collateral pledged at the FED, including the haircut reflecting the perceived risk associated with holding the collateral.

12 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase (repurchase agreements) consist of the following:

	June 30, 2009	December 31, 2008
	(In thousands)	
Repurchase agreements, interest ranging from -1.75% to 5.39% (2008 - 2.29% to 5.39%) (1)	$ 4,130,092	$ 3,421,042

(1) As of June 30, 2009, certain U.S. Treasury securities repurchase agreements amounting to $66.4 million were arranged at negative rates.

Table of Contents

Repurchase agreements mature as follows:

	June 30, 2009 (In thousands)
One to thirty days	$ 1,142,592
Over thirty to ninety days	
Over ninety days to one year	587,500
One to three years	1,000,000
Three to five years	900,000
Over five years	500,000
Total	$ 4,130,092

As of June 30, 2009 and December 31, 2008, the securities underlying such agreements were delivered to the dealers with whom the repurchase agreements were transacted.

Repurchase agreements as of June 30, 2009, grouped by counterparty, were as follows:

(Dollars in thousands)

Counterparty	Amount	Weighted-Average Maturity (In Months)
Credit Suisse First Boston	$ 1,383,031	22
Dean Witter / Morgan Stanley	796,500	14
Citigroup Global Markets	694,830	38
JP Morgan	585,151	27
Barclays Capital	570,580	26
UBS Financial Services, Inc.	100,000	37
	$ 4,130,092	

13 ADVANCES FROM THE FEDERAL HOME LOAN BANK (FHLB)

Following is a summary of the advances from the FHLB:

	June 30, 2009	December 31, 2008
	(In thousands)	
Fixed-rate advances from FHLB, with a weighted-average interest rate of 2.41% (2008 - 3.09%)	$ 1,325,440	$ 1,060,440

32

Table of Contents

Advances from FHLB mature as follows:

	(In thousands)
One to thirty days	$ 525,000
Over thirty to ninety days	
Over ninety days to one year	60,000
One to three years	507,000
Three to five years	233,440
Total	$ 1,325,440

As of June 30, 2009, the Corporation had additional capacity of approximately $402 million on this credit facility based on collateral pledged at the FHLB, including the haircut reflecting the perceived risk associated with holding the collateral.

14 NOTES PAYABLE

Notes payable consist of:

	June 30, 2009	December 31, 2008
	(In thousands)	
Callable step-rate notes, bearing step increasing interest from 5% to 7% (5.50% as of June 30, 2009 and December 31, 2008) maturing on October 18, 2019, measured at fair value under SFAS 159	$ 11,565	$ 10,141
Dow Jones Industrial Average (DJIA) linked principal protected notes:		
Series A maturing on February 28, 2012	6,095	6,245
Series B maturing on May 27, 2011	6,728	6,888
Total	$ 24,388	$ 23,274

15 OTHER BORROWINGS

Other borrowings consist of:

	June 30, 2009	December 31, 2008
	(In thousands)	
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.75% over 3-month LIBOR (3.36% as of June 30, 2009 and 4.62% as of December 31, 2008)	$ 103,093	$ 103,048
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.50% over 3-month LIBOR (3.11% as of June 30, 2009 and 4.00% as of December 31, 2008)	128,866	128,866
Total	$ 231,959	$ 231,914

16 STOCKHOLDERS EQUITY

Common stock

The Corporation has 250,000,000 authorized shares of common stock with a par value of $1 per share. As of June 30, 2009 and December 31, 2008, there were 102,444,549 shares issued and 92,546,749 shares outstanding. In February 2009, the Corporation s Board of Directors declared a first quarter cash dividend of $0.07 per common share which was paid on March 31, 2009 to common stockholders of record on March 15, 2009 and in May 2009 declared a second quarter dividend of $0.07 per common share which was paid on June 30, 2009 to common stockholders of record on June 15, 2009. On July 30, 2009, the Corporation announced the suspension of common and preferred dividends effective with the preferred dividend for the month of August 2009.

Stock repurchase plan and treasury stock

The Corporation has a stock repurchase program under which from time to time it repurchases shares of common stock in the open market and holds them as treasury stock. No shares of common stock were repurchased during 2009 and 2008 by the Corporation. As of June 30, 2009 and December 31, 2008, of the total amount of common stock repurchased, 9,897,800 shares were held as treasury stock and were available for general corporate purposes.

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 shall have such rights and preferences as shall be fixed by the Board of Directors when authorizing the issuance of that particular series. As of June 30, 2009, 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% non-cumulative perpetual monthly income preferred stock, Series E, which trade on the NYSE. The liquidation value per share is $25. Annual dividends of $1.75 per share (Series E), $1.8125 per share (Series D), $1.85 per share (Series C), $2.0875 per share (Series B) and $1.78125 per share (Series A) are payable monthly, if declared by the Board of Directors. Dividends declared on the non-convertible non-cumulative preferred stock for the first half of 2009 and 2008 amounted to $20.1 million.

In January 2009, in connection with the TARP Capital Purchase Program, established as part of the Emergency Economic Stabilization Act of 2008, the Corporation issued to the U.S. Treasury 400,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series F, $1,000 liquidation preference value per share. The Series F Preferred Stock has a call feature after three years. In connection with this investment, the Corporation also

Table of Contents

issued to the U.S. Treasury a 10-year warrant (the Warrant) to purchase 5,842,259 shares of the Corporation s common stock at an exercise price of $10.27 per share. The Corporation registered the Series F Preferred Stock, the Warrant and the shares of common stock underlying the Warrant for sale under the Securities Act of 1933. The allocated carrying values of the Series F Preferred Stock and the Warrant on the date of issuance (based on the relative fair values) were $374.2 million and $25.8 million, respectively. The Series F Preferred Stock will accrete to the redemption price of $400 million over five years.

The Series F Preferred Stock qualifies as Tier 1 regulatory capital. Cumulative dividends on the Series F Preferred Stock accrue on the liquidation preference amount on a quarterly basis at a rate of 5% per annum for the first five years, and thereafter at a rate of 9% per annum, but will only be paid when, as and if declared by the Corporation s Board of Directors out of assets legally available therefore. The Series F Preferred Stock ranks pari passu with the Corporation s existing Series A through E, in terms of dividend payments and distributions upon liquidation, dissolution and winding up of the Corporation. The Purchase Agreement of this issuance contains limitations on the payment of dividends on common stock, including limiting regular quarterly cash dividends to an amount not exceeding the last quarterly cash dividend paid per share, or the amount publicly announced (if lower), of common stock prior to October 14, 2008, which is $0.07 per share. For the six-month period ended June 30, 2009, preferred stock dividends of Series F Preferred Stock amounted to $9.2 million, including $2.6 million of cumulative preferred dividends not declared as of the end of the period.

The Warrant has a 10-year term and is exercisable at any time. The exercise price and the number of shares issuable upon exercise of the Warrant are subject to certain anti-dilution adjustments.

The possible future issuance of equity securities through the exercise of the warrant could affect the Corporation s current stockholders in a number of ways, including by:

- diluting the voting power of the current holders of common stock (the shares underlying the Warrant represent approximately 6% of the Corporation s shares of common stock as of June 30, 2009);
- diluting the earnings per share and book value per share of the outstanding shares of common stock; and
- making the payment of dividends on common stock more expensive.

As mentioned above, on July 30, 2009, the Corporation announced the suspension of dividends for common and all its outstanding series of preferred stock. This suspension is effective with the dividends for the month of August 2009, on the Corporation s five outstanding series of non-cumulative preferred stock and dividends for the Corporation s outstanding Series F Cumulative Preferred Stock and the Corporation s common stock.

Table of Contents

17 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 creditable, within certain conditions and limitations, against the Corporation s Puerto Rico tax liability. The Corporation is also subject to U.S. Virgin Islands taxes on its income from sources within that jurisdiction. Any such tax paid is creditable against the Corporation s Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 1994, as amended (PR Code), First BanCorp is subject to a maximum statutory tax rate of 39%. In 2009 the Puerto Rico Government approved Act No. 7 (the Act), to stimulate Puerto Rico s economy and to reduce the Puerto Rico Government s fiscal deficit. The Act imposes a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which is applicable to corporations, among others, whose combined income exceeds $100,000, effectively resulting in an increase in the maximum statutory tax rate from 39% to 40.95%. This temporary measure is effective for tax years that commenced after December 31, 2008 and before January 1, 2012. The PR Code also includes an alternative minimum tax of 22% that applies if the Corporation s regular income tax liability is less than the alternative minimum tax requirements.

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 International Banking Entities (IBEs) of the Corporation and the Bank and through the Bank s subsidiary FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation. Under the Act, all IBEs are subject to a special 5% tax on their net income not otherwise subject to tax pursuant to the PR Code. This temporary measure is also effective for tax years that commence after December 31, 2008 and before January 1, 2012. The IBEs 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. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs net income exceeds 20% of the bank s total net taxable income.

For the six-month period ended June 30, 2009, the Corporation recognized an income tax benefit of $112.3 million, compared to an income tax benefit of $17.2 million recorded for the same period in 2008. The positive fluctuation in the financial results was mainly related to increased deferred tax benefits due to net operating losses carryforward recorded as a result of current taxable losses and due to lower taxable income and adjustments to the deferred tax asset, as a result of the aforementioned changes to the PR Code enacted tax rates. The Corporation recorded an additional income tax benefit of $6.0 million for the six-month period ended

Table of Contents

June 30, 2009 in connection with changes to enacted tax rates, net of a $3.6 million provision recorded for the operations of FirstBank Overseas Corporation. Deferred tax amounts have been adjusted for the effect of the change in the income tax rate considering the enacted tax rate expected to apply to taxable income in the period in which the deferred tax asset or liability is expected to be settled or realized.

As of June 30, 2009, the Corporation evaluated its ability to realize the deferred tax asset and concluded, based on the evidence available, that it is more likely than not that some of the deferred tax asset will not be realized and, thus, established a valuation allowance of $5.5 million, compared to a valuation allowance of $7.3 million as of December 31, 2008. As of June 30, 2009, the deferred tax asset, net of the valuation allowance of $5.5 million, amounted to approximately $217.8 million compared to $128.0 million, net of the valuation allowance of $7.3 million as of December 31, 2008.

FASB Interpretation No. 48 (FIN 48) 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 FIN 48, income tax benefits are recognized and measured based upon a two-step model: 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 in accordance with FIN 48 and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit (UTB).

As of June 30, 2009, the balance of the Corporation s UTBs amounted to $4.7 million (excluding accrued interest), all of which, if recognized, would affect the Corporation s effective tax rate. The Corporation classifies all interest and penalties, if any, related to tax uncertainties as income tax expense. As of June 30, 2009 and December 31, 2008, the Corporation s accrual for interest that relates to tax uncertainties amounted to $2.1 million and $6.8 million, respectively. As of June 30, 2009, there is no need to accrue for the payment of penalties. For the six-month period ended on June 30, 2009 and 2008, the total amount of interest recognized by the Corporation as part of income tax expense related to tax uncertainties was $0.5 million and $0.8 million, respectively. The amount of UTBs may increase or decrease in the future for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management s judgment about the level of uncertainty, the status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions. During the second quarter of 2009, the Corporation reversed UTBs by $10.8 million and related accrued interest of $3.5 million due to the lapse of the statute of limitations for the 2004 taxable year.

The Corporation s UTBs and interest relate to tax years still subject to review by taxing authorities. Audit periods remain open for review until the statute of limitations has expired. The statute of limitations under the PR Code is 4 years, and for Virgin Islands and U.S. income tax purposes is 3 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.

In July 2009, the Corporation entered into an agreement with the Puerto Rico Department of the Treasury to conclude an income tax investigation and to eliminate all possible income and withholding tax deficiencies related to taxable years 2005, 2006, 2007 and 2008. As a result of such agreement, the Corporation will reverse during the third quarter of 2009 the remaining UTBs and related interest by approximately $2.9 million, net of the payment made to the Puerto Rico Department of the Treasury in connection with the conclusion of the tax investigation.

18 FAIR VALUE

SFAS 159 generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. The Corporation elected to adopt the fair value option for certain of its brokered CDs and medium-term notes (SFAS 159 liabilities) on the adoption date.

Fair Value Option

Callable Brokered CDs and Certain Medium-Term Notes

The Corporation elected the fair value option for certain financial liabilities that were hedged with interest rate swaps that were previously designated for fair value hedge accounting in accordance with SFAS 133. As of June 30, 2009 and December 31, 2008, these liabilities included certain medium-term notes with a fair value of $11.6 million and $10.1 million, respectively, and principal balance of $15.4 million recorded in notes payable. As of December 31, 2008, liabilities recognized at fair value also included callable brokered CDs with an aggregate fair value of $1.15 billion and principal balance of $1.13 billion, recorded in interest-bearing deposits. Interest paid/accrued on these instruments is recorded as part of interest expense and the accrued interest is part of the fair value of the SFAS 159 liabilities. Electing the fair value option allows the Corporation to eliminate the burden of complying with the requirements for hedge accounting under SFAS 133 (e.g., documentation and effectiveness assessment) without introducing earnings volatility. Interest rate risk on the callable brokered CDs measured at fair value under SFAS 159 was economically hedged with callable interest rate swaps, with the same terms and conditions, until they were all called during 2009. The Corporation did not elect the fair value option for the vast majority of other brokered CDs because these are not hedged by derivatives.

Medium-term notes and callable brokered CDs for which the Corporation elected the fair value option were priced using observable market data in the institutional markets.

Fair Value Measurement

Table of Contents

SFAS 157 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. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 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 are traded 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.

Level 2 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 and financial liabilities (e.g., callable brokered CDs and medium-term notes elected for the fair value option under SFAS 159) 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.

Level 3 Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and that 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 requires significant management judgment or estimation.

Estimated Fair Value of Financial Instruments

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

The estimated fair value is subjective in nature and involves uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in the underlying assumptions used in calculating fair value could significantly affect the

results. In addition, the fair value estimates are based on outstanding balances without attempting to estimate the value of anticipated future business.

The following table presents the estimated fair value and carrying value of financial instruments as of June 30, 2009 and December 31, 2008.

	Total Carrying Amount in Statement of Financial Condition 6/30/2009(1)	Fair Value Estimated 6/30/2009(2)	Total Carrying Amount in Statement of Financial Condition 12/31/2008(1)	Fair Value Estimated 12/31/2008(2)
	(In thousands)			
Assets:				
Cash and due from banks and money market investments	$ 247,788	$ 247,788	$ 405,733	$ 405,733
Investment securities available for sale	5,527,981	5,527,981	3,862,342	3,862,342
Investment securities held to maturity	686,931	703,430	1,706,664	1,720,412
Other equity securities	83,430	83,430	64,145	64,145
Loans receivable, including loans held for sale	13,135,710		13,088,292	
Less: allowance for loan and lease losses	(407,746)		(281,526)	
Loans, net of allowance	12,727,964	12,769,659	12,806,766	12,416,603
Derivatives, included in assets	4,898	4,898	8,010	8,010
Liabilities:				
Deposits	12,035,427	12,175,191	13,057,430	13,221,026
Loans payable	135,000	135,000		
Federal funds purchased and securities sold under agreements to repurchase	4,130,092	4,308,099	3,421,042	3,655,652
Advances from FHLB	1,325,440	1,367,332	1,060,440	1,079,298
Notes payable	24,388	22,940	23,274	18,755
Other borrowings	231,959	76,727	231,914	81,170
Derivatives, included in liabilities	6,669	6,669	8,505	8,505

(1) This column discloses carrying amount, required by FSP FAS 107-1 and APB 28-1.

(2) This column discloses fair value estimates, required by FSP FAS 107-1 and

APB 28-1.

Assets and liabilities measured at fair value on a recurring basis, including financial liabilities for which the Corporation has elected the fair value option, are summarized below:

	As of June 30, 2009 Fair Value Measurements Using				As of December 31, 2008 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 [(1)]	$97,238	$5,334,175	$96,568	$5,527,981	$2,217	$3,746,142	$113,983	$3,862,342
Derivatives, included in assets [(1)]		1,384	3,514	4,898		7,250	760	8,010
Liabilities:								
Callable brokered CDs [(2)]						1,150,959		1,150,959
Medium-term notes [(2)]		11,565		11,565		10,141		10,141
Derivatives, included in liabilities [(1)]		6,669		6,669		8,505		8,505

(1) Carried at fair value prior to the adoption of SFAS 159.

(2) Items for which the Corporation has elected the fair value option under SFAS 159.

40

(In thousands)	Changes in Fair Value for the Quarter Ended June 30, 2009, for items Measured at Fair Value Pursuant to Election of the Fair Value Option			Changes in Fair Value for the Six-Month Period Ended June 30, 2009, for items Measured at Fair Value Pursuant to Election of the Fair Value Option		
	Unrealized Losses and Interest Expense included in Interest Expense on Deposits [1]	Unrealized Gains and Interest Expense included in Interest Expense on Notes Payable [1]	Total Changes in Fair Value Unrealized (Losses) Gains and Interest Expense included in Current-Period Earnings [1]	Unrealized Gains and Interest Expense included in Interest Expense on Deposits [1]	Unrealized Losses and Interest Expense included in Interest Expense on Notes Payable [1]	Total Changes in Fair Value Unrealized Gains (Losses) and Interest Expense included in Current-Period Earnings [1]
Callable brokered CDs	$ (287)	$	$ (287)	$ (2,068)	$	$ (2,068)
Medium-term notes		(1,892)	(1,892)		(1,849)	(1,849)
	$ (287)	$ (1,892)	$ (2,179)	$ (2,068)	$ (1,849)	$ (3,917)

(1) Changes in fair value for the quarter and six-month period ended June 30, 2009 include interest expense on callable brokered CDs of $1.8 million, and $10.8 million, respectively, and interest expense on medium-term notes of $0.2 million and $0.4 million, respectively.

Interest expense on callable brokered CDs and medium-term notes that have been elected to be carried at fair value under the provisions of SFAS 159 are recorded in interest expense in the Consolidated Statement of Income based on their contractual coupons.

	Changes in Fair Value for the Quarter Ended June 30, 2008, for items Measured at Fair Value Pursuant to Election of the Fair Value Option			Changes in Fair Value for the Six-Month Period Ended June 30, 2008, for items Measured at Fair Value Pursuant to Election of the Fair Value Option		
(In thousands)	Unrealized Gains and Interest Expense included in Interest Expense on Deposits (1)	Unrealized Gains and Interest Expense included in Interest Expense on Notes Payable (1)	Total Changes in Fair Value Unrealized Gains and Interest Expense included in Current-Period Earnings (1)	Unrealized Losses and Interest Expense included in Interest Expense on Deposits (1)	Unrealized Gains and Interest Expense included in Interest Expense on Notes Payable (1)	Total Changes in Fair Value Unrealized (Losses) Gains and Interest Expense included in Current-Period Earnings (1)
Callable brokered CDs	$ (1,320)	$	$ (1,320)	$ (99,992)	$	$ (99,992)
Medium-term notes		(211)	(211)		474	474
	$ (1,320)	$ (211)	$ (1,531)	$ (99,992)	$ 474	$ (99,518)

(1) Changes in fair value for the quarter and

six-month period ended June 30, 2008 include interest expense on callable brokered CDs of $29.8 million, and $78.9 million, respectively, and interest expense on medium-term notes of $0.2 million and $0.4 million, respectively. Interest expense on callable brokered CDs and medium-term notes that have been elected to be carried at fair value under the provisions of SFAS 159 are recorded in interest expense in the Consolidated Statement of Income based on their contractual coupons.

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 six-month periods ended June 30, 2009 and 2008.

	Total Fair Value Measurements (Quarter Ended June 30, 2009)		**Total Fair Value Measurements (Six-Month Period Ended June 30, 2009)**	
(In thousands)	**Derivatives (1)**	**Securities Available For Sale (2)**	**Derivatives (1)**	**Securities Available For Sale (2)**
Beginning balance	$ 982	$ 110,982	$ 760	$ 113,983
Total gains or (losses) (realized / unrealized):				

Included in earnings	2,532	(1,061)	2,754	(1,061)
Included in other comprehensive income		(2,372)		(1,244)
Principal repayments and amortization		(10,981)		(15,110)
Ending balance	$ 3,514	$ 96,568	$ 3,514	$ 96,568

(1) Amounts related to the valuation of interest rate cap agreements which were carried at fair value prior to the adoption of SFAS 159.

(2) Amounts mostly related to certain private label mortgage-backed securities which were carried at fair value prior to the adoption of SFAS 159.

	Total Fair Value Measurements (Quarter Ended June 30, 2008)		**Total Fair Value Measurements (Six-Month Period Ended June 30, 2008)**	
(In thousands)	**Derivatives (1)**	**Securities Available For Sale (2)**	**Derivatives (1)**	**Securities Available For Sale (2)**
Beginning balance	$ 2,888	$ 119,051	$ 5,103	$ 133,678
Total gains or (losses) (realized / unrealized):				
Included in earnings	3,095		880	
Included in other comprehensive income		3,025		(7,607)
Principal repayments and amortization		(6,886)		(10,881)
Ending balance	$ 5,983	$ 115,190	$ 5,983	$ 115,190

(1) Amounts related to the valuation of interest rate cap agreements which were carried at fair value prior to the adoption of SFAS 159.

(2) Amounts mostly related to certain private label mortgage-backed securities which were carried at fair value prior to the adoption of SFAS 159.

Table of Contents

The table below summarizes changes in unrealized gains and losses recorded in earnings for the quarters and six-month periods ended June 30, 2009 and 2008 for Level 3 assets and liabilities that are still held as of the end of each period.

(In thousands)	Changes in Unrealized Gains (Losses) Quarter Ended June 30, 2009		Changes in Unrealized Gains (Losses) Six-Month Period Ended June 30, 2009	
	Derivatives	**Securities Available For Sale**	**Derivatives**	**Securities Available For Sale**
Changes in unrealized gains (losses) relating to assets still held at reporting date [(1)]				
Interest income on loans	$ 43	$	$ 48	$
Interest income on investment securities	2,489		2,706	
Net impairment losses on investment securities		(1,061)		(1,061)
	$ 2,532	$ (1,061)	$ 2,754	$ (1,061)

(1) Unrealized losses of $2.4 million and $1.2 million on Level 3 available-for-sale securities was recognized as part of comprehensive income for the quarter and six-month period ended June 30, 2009.

(In thousands)	Changes in Unrealized Gains (Losses) Quarter Ended June 30, 2008		Changes in Unrealized Gains (Losses) Six-Month Period Ended June 30, 2008	
	Derivatives	**Securities Available For Sale**	**Derivatives**	**Securities Available For Sale**
Changes in unrealized gains (losses) relating to assets still held at reporting date [(1)]				
Interest income on loans	$ 54	$	$ 23	$
Interest income on investment securities	3,041		857	

Net impairment losses on investment securities				
	$ 3,095	$	$ 880	$

(1) Unrealized gain of $3.0 million and unrealized loss of $7.6 million on Level 3 available-for-sale securities was recognized as part of comprehensive income for the quarter and six-month period ended June 30, 2008.

Additionally, fair value is used on a non-recurring 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 June 30, 2009, 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 June 30, 2009			**Losses recorded for the Quarter Ended June 30, 2009**	**Losses recorded for the Six-month period ended June 30, 2009**
(In thousands)	**Level 1**	**Level 2**	**Level 3**		
Loans receivable [1]	$	$	$759,241	$ 80,146	$ 117,880
Other Real Estate Owned [2]			58,064	3,677	5,695
Core deposit intangible [3]			7,348	270	3,988

(1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral in accordance with the

provisions of SFAS 114. The fair values are 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 collateral (e.g. absorption rates), which are not market observable.

(2) The fair value is 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), which are not market observable. Losses are related to market valuation adjustments after the transfer from the loan to the Other Real

Estate Owned (OREO) portfolio.

(3) Amount represents core deposit intangible of FirstBank Florida. The impairment was generally measured based on internal information about decreases in the base of core deposits acquired upon the acquisition of FirstBank Florida.

Table of Contents

As of June 30, 2008, 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 June 30, 2008			Losses recorded for the Quarter Ended June 30, 2008	Losses recorded for the Six-month period ended June 30, 2008
	Level 1	Level 2	Level 3		
(In thousands)					
Loans receivable [1]	$	$	$175,341	$ 21,896	$ 40,685
Other Real Estate Owned [2]			38,620	522	843
Loans held for sale [3]		29,194		457	457

(1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral in accordance with the provisions of SFAS 114. The fair values are 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 collateral (e.g. absorption rates), which are not market observable.

(2) The fair value is 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), which are not market observable. Losses are related to market valaution adjustments after the transfer from the loan to the OREO portfolio.

(3) Fair value is primarily derived from quotations based on the mortgage-backed securities market.

The following is a description of the valuation methodologies used for instruments for which an estimated fair value is presented as well as for instruments for which the Corporation has elected the fair value option. 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 amount of cash and due from banks and money market investments are reasonable estimates of their fair value. Money market investments include held-to-maturity U.S. Government obligations, 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.

Investment securities available for sale and held to maturity

The fair value of investment securities is the market value based on quoted market prices, when available, or market prices for identical or comparable assets 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. 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. Refer to Note 4 for additional information about the fair value of private label mortgage-backed securities.

Other equity securities

Equity or other securities that do not have a readily available fair value are stated at the net realizable value which management believes is a reasonable proxy for their fair value.

Table of Contents

This category is principally composed of stock that is owned by the Corporation to comply with Federal Home Loan Bank (FHLB) regulatory requirements. Their realizable value equals their cost as these shares can be freely redeemed at par.

Loans receivable, including loans held for sale

The fair value of all loans was estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms and credit quality and with adjustments that the Corporation s nanagement believes a market participant would consider in determining fair value. Loans were classified by type such as commercial, residential mortgage, credit cards and automobile. These asset categories were further segmented into fixed- and adjustable-rate categories. The fair values of performing fixed-rate and adjustable-rate loans were calculated by discounting expected cash flows through the estimated maturity date. 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 prepayment experiences of generic U.S. mortgage-backed securities pools with similar characteristics (e.g. coupon and original term) and adjusted based on the Corporation s historical data. 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, in accordance with the provisions of SFAS 114.

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. For deposits with stated maturities, but that reprice at least quarterly, the fair value is also estimated to be the recorded amounts 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 are 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 valuation uses a

Hull-White Interest Rate Tree approach, an industry-standard approach for valuing instruments with interest rate call options. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market prices. The fair value does not incorporate the risk of nonperformance, since brokered CDs are generally participated out by brokers in shares of less than $100,000 and insured by the FDIC.

Loans payable

Loans payable consisted of short-term borrowings under the FED Discount Window Program. Due to the short-term nature of these borrowings, their outstanding balances are estimated to be the fair value.

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. 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. For advances from FHLB that reprice quarterly, their outstanding balances are estimated to be their fair value. Advances from FHLB are fully collateralized by mortgage loans and, to a lesser extent, investment securities.

Derivative instruments

The fair value of most of the derivative instruments is based on observable market parameters and takes into consideration the credit risk component, when appropriate. The Hull-White Interest Rate Tree approach is used to value the option components of derivative instruments, and discounting of the cash flows is performed using USD dollar LIBOR-based discount rates or yield curves that account for the industry sector and the credit rating of the counterparty and/or the Corporation. Derivatives include interest rate swaps used for protection against rising interest rates and prior to June 30, 2009 included interest rate swaps to economically hedge brokered CDs and medium-term notes. 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 collateral to the Corporation.

Certain derivatives with limited market activity, as is the case with derivative instruments named as reference caps, are valued using models that consider unobservable market parameters (Level 3). Reference caps are used mainly to hedge interest rate risk inherent in private label mortgage-backed securities, thus are tied to the notional amount of the underlying fixed-rate mortgage loans originated in the United States. Significant inputs used for fair value determination consist of specific characteristics such as information used in the prepayment model which follows the amortizing schedule of the underlying loans, which is an unobservable input. The valuation model uses the Black formula, which is a benchmark standard in the financial industry. The Black formula is similar to the Black-Scholes formula for valuing stock options except that the spot price of the underlying is replaced by the forward price. The Black formula uses as inputs the strike price of the cap, forward LIBOR rates, volatility estimates and discount rates to estimate the option value. LIBOR rates and swap rates are obtained from Bloomberg L.P. (Bloomberg) every day and build zero coupon curve based on the Bloomberg LIBOR/Swap curve. The discount factor is then calculated from the zero coupon curve. The cap is the sum of all caplets. For each caplet, the rate is reset at the beginning of each reporting period and payments are made at the end of each period. The cash flow of each caplet is then discounted from each payment date.

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 resulted in an unrealized loss of approximately $0.8 million as of June 30, 2009, of which an unrealized loss of $2.7 million was recorded in the first half of 2009 and an unrealized gain of $0.1 million in the first half of 2008.

Term notes payable

The fair value of term notes is determined using a discounted cash flow analysis over the full term of the borrowings. This valuation also uses the Hull-White Interest Rate Tree approach to value the option components of the term notes. The model assumes that the embedded options are exercised economically. The fair value of medium-term notes is computed using the notional amount outstanding. The discount rates used in the valuations are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market prices and value the cancellation option in the term notes. For the medium-term notes, the credit risk is measured 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 note and option. The net loss from fair value changes attributable to the Corporation s own credit to the medium-term notes for which the Corporation has elected the fair value option amounted to $10.1 million for the first half of 2009 and an unrealized gain of $0.9 million for the first half of 2008. The cumulative mark-to-market unrealized loss on the medium-term notes since the adoption of SFAS 159 attributable to credit risk amounted to $4.4 million as of June 30, 2009.

Table of Contents

Other borrowings

Other borrowings consist of junior subordinated debentures. Projected cash flows from the debentures were discounted using the LIBOR yield 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 (US Finance BB) as issuer of the note at a tenor comparable to the time to maturity of the debentures.

19 SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information follows:

	Six-Month Period Ended June 30,	
	2009	**2008**
	(In thousands)	
Cash paid for:		
Interest on borrowings	$283,134	$367,767
Income tax	319	2,082
Non-cash investing and financing activities:		
Additions to other real estate owned	52,862	36,171
Additions to auto repossesion	40,048	44,497
Capitalization of servicing assets	3,181	515
Loan securitizations	187,815	
Non-cash acquisition of mortgage loans that previously served as collateral of a commercial loan to a local financial institution	205,395	

On January 28, 2008, the Corporation completed the acquisition of Virgin Islands Community Bank (VICB), with operations in St. Croix, U.S. Virgin Islands, at a purchase price of $2.5 million. The Corporation acquired cash of approximately $7.7 million from VICB.

20 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 legal entities. As of June 30, 2009, the Corporation had four reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; and Treasury and Investments. There is also an Other category reflecting other legal entities reported separately on an aggregate basis. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation s organizational chart, nature of the products, distribution channels and the economic characteristics of the products 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 other products such as cash management and business management services. The Mortgage Banking segment s operations consist 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 loans funds to the Commercial and Corporate Banking, Mortgage Banking and Consumer (Retail) Banking segments to finance their lending activities and borrows from those segments. The Consumer (Retail) Banking segment also loans funds to other segments. The interest rates charged or credited by Treasury and Investments and the Consumer (Retail) Banking 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 Other category is mainly composed of insurance, finance leases and other products.

The accounting policies of the business segments are the same as those described in Note 1 to the Corporation s financial statements for the year ended December 31, 2008 contained in the Corporation s Annual Report on Form 10-K.

The Corporation evaluates the performance of the segments based on net interest income after 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.

Table of Contents

The following table presents information about the reportable segments (in thousands):

	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	Other	Total
For the quarter ended June 30, 2009:						
Interest income	$ 45,212	$ 39,925	$ 72,065	$ 66,499	$ 29,079	$ 252,780
Net (charge) credit for transfer of funds	(31,837)	17,248	(20,431)	34,877	143	
Interest expense		(18,353)		(96,456)	(6,957)	(121,766)
Net interest (loss) income	13,375	38,820	51,634	4,920	22,265	131,014
Provision for loan and lease losses	(14,683)	(15,000)	(194,162)		(11,307)	(235,152)
Non-interest income	2,402	7,004	1,280	8,365	4,364	23,415
Direct non-interest expenses	(9,539)	(27,006)	(17,487)	(1,990)	(12,974)	(68,996)
Segment (loss) income	$ (8,445)	$ 3,818	$ (158,735)	$ 11,295	$ 2,348	$ (149,719)
Average earnings assets	$ 3,009,312	$ 1,783,988	$ 7,158,541	$ 6,015,921	$ 1,351,426	$ 19,319,188
For the quarter ended June 30, 2008:						
Interest income	$ 47,455	$ 40,022	$ 85,666	$ 71,254	$ 32,211	$ 276,608
Net (charge) credit for transfer of funds	(35,066)	23,808	(49,502)	64,451	(3,691)	
Interest expense		(19,563)		(114,004)	(8,435)	(142,002)
Net interest income	12,389	44,267	36,164	21,701	20,085	134,606
Provision for loan and lease losses	(1,259)	(14,414)	(20,037)		(5,613)	(41,323)
Non-interest income (loss)	853	6,674	1,137	(587)	3,925	12,002
Direct non-interest expenses	(6,125)	(25,546)	(8,099)	(1,586)	(11,400)	(52,756)
Segment income	$ 5,858	$ 10,981	$ 9,165	$ 19,528	$ 6,997	$ 52,529
Average earnings assets	$ 2,909,308	$ 1,720,661	$ 5,992,390	$ 5,487,619	$ 1,357,393	$ 17,467,371
For the six-month period ended June 30, 2009:						
Interest income	$ 92,627	$ 80,727	$ 142,362	$ 136,255	$ 59,132	$ 511,103
Net (charge) credit for transfer of funds	(66,141)	37,048	(49,900)	79,029	(36)	
Interest expense		(37,442)		(206,365)	(14,684)	(258,491)
Net interest income	26,486	80,333	92,462	8,919	44,412	252,612

Provision for loan and lease losses	(23,125)	(19,242)	(230,447)		(21,767)	(294,581)
Non-interest income	3,239	13,877	2,546	25,887	7,919	53,468
Direct non-interest expenses	(17,023)	(52,233)	(27,464)	(3,712)	(29,250)	(129,682)
Segment (loss) income	$ (10,423)	$ 22,735	$ (162,903)	$ 31,094	$ 1,314	$ (118,183)
Average earnings assets	$ 3,043,468	$ 1,807,617	$ 6,960,139	$ 5,788,847	$ 1,354,233	$ 18,954,304
For the six-month period ended June 30, 2008:						
Interest income	$ 92,560	$ 82,412	$ 179,746	$ 135,872	$ 65,105	$ 555,695
Net (charge) credit for transfer of funds	(69,146)	45,999	(107,276)	135,109	(4,686)	
Interest expense		(38,725)		(240,675)	(17,231)	(296,631)
Net interest income	23,414	89,686	72,470	30,306	43,188	259,064
Provision for loan and lease losses	(6,968)	(28,989)	(33,081)		(18,078)	(87,116)
Non-interest income	1,229	13,968	2,148	15,734	8,303	41,382
Direct non-interest expenses	(12,505)	(53,115)	(17,596)	(3,436)	(22,839)	(109,491)
Segment income	$ 5,170	$ 21,550	$ 23,941	$ 42,604	$ 10,574	$ 103,839
Average earnings assets	$ 2,861,979	$ 1,732,717	$ 5,923,744	$ 5,297,547	$ 1,353,989	$ 17,169,976

49

The following table presents a reconciliation of the reportable segment financial information to the consolidated totals (in thousands):

	Quarter Ended June 30,		Six-month Period Ended June 30,	
	2009	2008	2009	2008
Net (loss) income:				
Total (loss) income for segments and other	$ (149,719)	$ 52,529	$ (118,183)	$ 103,839
Other operating expenses	(26,992)	(29,007)	(50,834)	(54,459)
(Loss) income before income taxes	(176,711)	23,522	(169,017)	49,380
Income tax benefit	98,053	9,472	112,250	17,203
Total consolidated net (loss) income	$ (78,658)	$ 32,994	$ (56,767)	$ 66,583
Average assets:				
Total average earning assets for segments	$ 19,319,188	$ 17,467,371	$ 18,954,304	$ 17,169,976
Average non-earning assets	741,908	759,060	731,277	712,651
Total consolidated average assets	$ 20,061,096	$ 18,226,431	$ 19,685,581	$ 17,882,627

21 COMMITMENTS AND CONTINGENCIES

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 commitments to sell mortgage loans at fair value. As of June 30, 2009, commitments to extend credit amounted to approximately $1.4 billion and standby letters of credit amounted to approximately $101.6 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. 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. In the case of credit cards and personal lines of credit, the Corporation can, at any time and without cause, cancel the unused credit facility. Generally, the Corporation s mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers.

The Corporation obtained from GNMA a Commitment Authority to issue GNMA mortgage-backed securities for approximately $301.5 million. Under this program, as of June 30, 2009, the Corporation had securitized approximately $188 million of FHA/VA mortgage loan production into GNMA mortgage-backed securities.

Lehman Brothers Special Financing, Inc. (Lehman) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constitutes an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement due as of June 30, 2009, under the swap agreements, the Corporation has an

unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately $1.4 million. This exposure was reserved in the third quarter of 2008. The Corporation had pledged collateral of $63.6 million with Lehman to guarantee its performance under the swap agreements in the event payment thereunder was required. The book value of pledged securities with Lehman as of June 30, 2009 amounted to approximately $64.5 million. The position of the Corporation with respect to the recovery of the collateral, after discussion with its outside legal counsel, is that at all times title to the collateral has been vested in the Corporation and that, therefore, this collateral should not, for any purpose, be considered property of the bankruptcy estate available for distribution among Lehman s creditors. On January 30, 2009, the Corporation filed a customer claim with the trustee and at this time the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value. As additional relevant facts become available in future periods, a need to recognize a partial or full reserve of this claim may arise. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation decided to classify such investments as non-performing during the second quarter of 2009.

As of June 30, 2009, 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 will not have a material adverse effect on the Corporation s financial position or results of operations.

Table of Contents

22 FIRST BANCORP (Holding Company Only) Financial Information

The following condensed financial information presents the financial position of the Holding Company only as of June 30, 2009 and December 31, 2008 and the results of its operations for the quarters and six-month periods ended June 30, 2009 and 2008.

	As of June 30, 2009	As of December 31, 2008
	(In thousands)	
Assets		
Cash and due from banks	$ 83,394	$ 58,075
Money market investments	300	300
Investment securities available for sale, at market:		
Equity investments	528	669
Other investment securities	1,550	1,550
Investment in FirstBank Puerto Rico, at equity	1,805,023	1,574,940
Investment in FirstBank Insurance Agency, at equity	6,552	5,640
Investment in Ponce General Corporation, at equity	160,438	123,367
Investment in PR Finance, at equity	2,924	2,789
Investment in FBP Statutory Trust I	3,093	3,093
Investment in FBP Statutory Trust II	3,866	3,866
Other assets	5,753	6,596
Total assets	$ 2,073,421	$ 1,780,885
Liabilities & Stockholders Equity		
Liabilities:		
Other borrowings	$ 231,959	$ 231,914
Accounts payable and other liabilities	776	854
Total liabilities	232,735	232,768
Stockholders equity	1,840,686	1,548,117
Total Liabilities & Stockholders Equity	$ 2,073,421	$ 1,780,885

Table of Contents

	Quarter Ended		Six-Month Period Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
	(In thousands)			
Income:				
Interest income on investment securities	$	$ 57	$	$ 790
Interest income on other investments		204	1	733
Dividends from FirstBank Puerto Rico	24,962	30,001	44,939	41,872
Dividends from other subsidiaries				2,500
Other income	69	93	141	213
	25,031	30,355	45,081	46,108
Expense:				
Notes payable and other borrowings	2,291	3,126	4,729	7,389
Interest on funding to subsidiaries				550
Recovery for loan losses				(1,398)
Other operating expenses	751	563	1,162	1,034
	3,042	3,689	5,891	7,575
Net loss on investments and impairments		(489)	(388)	(489)
Income before income taxes and equity in undistributed earnings of subsidiaries	21,989	26,177	38,802	38,044
Income tax provision	(11)	(1)	(3)	(546)
Equity in undistributed (losses) earnings of subsidiaries	(100,636)	6,818	(95,566)	29,085
Net (loss) income	$ (78,658)	$ 32,994	$ (56,767)	$ 66,583

23 SUBSEQUENT EVENTS

In July 2009, the Corporation entered into an agreement with the Puerto Rico Department of the Treasury to conclude an income tax investigation and to eliminate all possible income and withholding tax deficiencies related to taxable years 2005, 2006, 2007 and 2008. As a result of such agreement, the Corporation will reverse during the third quarter of 2009 the remaining UTBs and related interest by approximately $2.9 million, net of the payment made to the Puerto Rico Department of the Treasury in connection with the conclusion of the tax investigation. Also, the agreement provides a three-year moratorium on the deduction of the last installment of the Class Action payment made by the Corporation in 2007, according to a previous agreement entered with the Puerto Rico Department of the

Treasury in February 2008. This moratorium started on January 1, 2009 and will end on December 31, 2011. During this period, the Corporation will not be allowed to deduct any part of the last installment of $18.75 million for income tax purposes.

Effective July 1, 2009, the operations conducted by FirstBank Florida as a separate subsidiary were merged with and into FirstBank Puerto Rico, the Corporation s main banking subsidiary. As part of the Corporation s strategic planning it has been determined that business synergies can be achieved by merging FirstBank Florida with and into FirstBank Puerto Rico, which reorganization included the consolidation of FirstBank Puerto Rico s loan production office with the former thrift banking operations of FirstBank Florida. For the last three years the Corporation has been conducting dual banking operations in the Florida market, upon consummation of the merger, the consolidation of the former thrift banking operations with the loan production office

Table of Contents

resulted in FirstBank Puerto Rico having a more diversified and efficient banking operation in the form of a branch network in the Florida market. The merger allows the Florida operations to benefit by leveraging the capital position of FirstBank Puerto Rico and thereby provide it with the support necessary to grow in the Florida market.

The Corporation adopted SFAS 165 during the second quarter of 2009 and has evaluated subsequent events through August 10, 2009, which is the date the financial statements were issued. There are not any material subsequent events, other than those described above, which would require further disclosure.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)
SELECTED FINANCIAL DATA
(In thousands, except for per share and financial ratios)

	Quarter ended June 30, 2009	Quarter ended June 30, 2008	Six-month period ended June 30, 2009	Six-month period ended June 30, 2008
Condensed Income Statements:				
Total interest income	$ 252,780	$276,608	$ 511,103	$555,695
Total interest expense	121,766	142,002	258,491	296,631
Net interest income	131,014	134,606	252,612	259,064
Provision for loan and lease losses	235,152	41,323	294,581	87,116
Non-interest income	23,415	12,002	53,468	41,382
Non-interest expenses	95,988	81,763	180,516	163,950
(Loss) Income before income taxes	(176,711)	23,522	(169,017)	49,380
Income tax benefit	98,053	9,472	112,250	17,203
Net (loss) income	(78,658)	32,994	(56,767)	66,583
Net (loss) income attributable to common stockholders	(94,825)	22,925	(88,052)	46,445
Per Common Share Results:				
Net (loss) income per share basic	$ (1.03)	$ 0.25	$ (0.95)	$ 0.50
Net (loss) income per share diluted	$ (1.03)	$ 0.25	$ (0.95)	$ 0.50
Cash dividends declared	$ 0.07	$ 0.07	$ 0.14	$ 0.14
Average shares outstanding	92,511	92,505	92,511	92,505
Average shares outstanding diluted	92,511	92,708	92,511	92,650
Book value per common share	$ 9.88	$ 9.21	$ 9.88	$ 9.21
Tangible book value per common share (1)	$ 9.38	$ 8.62	$ 9.38	$ 8.62
Selected Financial Ratios (In Percent):				
Profitability:				
Return on Average Assets	(1.57)	0.72	(0.58)	0.74
Interest Rate Spread (2)	2.60	2.92	2.53	2.78
Net Interest Margin (2)	2.92	3.28	2.89	3.19
Return on Average Total Equity	(15.93)	9.16	(5.89)	9.26
Return on Average Common Equity	(36.14)	10.29	(16.99)	10.46
Average Total Equity to Average Total Assets	9.85	7.91	9.79	8.04
Tangible common equity ratio (1)	4.35	4.25	4.35	4.25
Dividend payout ratio	(6.84)	28.25	(14.73)	27.88
Efficiency ratio (3)	62.16	55.77	58.98	54.57
Asset Quality:				
Allowance for loan and lease losses to loans receivable	3.11	1.82	3.11	1.82
Net charge-offs (annualized) to average loans	3.85	0.97	2.52	0.91
Provision for loan and lease losses to net charge-offs	180.97	139.86	174.97	158.36
Non-performing assets to total assets	6.53	2.65	6.53	2.65
Non-accruing loans to total loans receivable	8.94	3.67	8.94	3.67

Allowance to total non-accruing loans	34.81	49.56	34.81	49.56
Allowance to total non-accruing loans excluding residential real estate loans	52.85	101.85	52.85	101.85
Other Information:				
Common Stock Price: End of period	$ 3.95	$ 6.34	$ 3.95	$ 6.34

	As of June 30, 2009	**As of December 31, 2008**
Balance Sheet Data:		
Loans and loans held for sale	$13,135,710	$13,088,292
Allowance for loan and lease losses	407,746	281,526
Money market and investment securities	6,368,167	5,709,154
Intangible assets	46,228	52,083
Deferred tax asset, net	217,843	128,039
Total assets	20,012,887	19,491,268
Deposits	12,035,427	13,057,430
Borrowings	5,846,879	4,736,670
Total preferred equity	926,259	550,100
Total common equity	868,045	940,628
Accumulated other comprehensive income, net of tax	46,382	57,389
Total equity	1,840,686	1,548,117

1- Non-gaap measures. Refer to Capital discussion below for additional information of the components and reconciliation of these measures.

2- On a tax equivalent basis and excluding the changes in fair value of derivative instruments and financial instruments measured at fair value under SFAS 159 (see Net Interest Income discussion below for a

reconciliation of this non-gaap measure).

3- Non-interest expenses 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 and financial instruments measured at fair value under SFAS 159.

Table of Contents

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

DESCRIPTION OF BUSINESS

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), Grupo Empresas de Servicios Financieros (d/b/a PR Finance Group) and FirstBank Insurance Agency. Through its wholly-owned subsidiaries, the Corporation operates offices in Puerto Rico, the United States and British Virgin Islands and the State of Florida (USA) specializing in commercial banking, residential mortgage loan originations, finance leases, personal loans, small loans, auto loans, vehicle rental and insurance agency services. Refer to Note 23 of the accompanying unaudited consolidated financial statements for information about operations conducted in Florida.

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 significantly affected the results for the second quarter and six-month period ended June 30, 2009, non-interest expenses (such as personnel, occupancy and other costs), non-interest income (mainly service charges and fees on loans and deposits and insurance income), the results of its hedging activities, gains (losses) on investments, gains (losses) on sale of loans, and income taxes.

Net loss for the quarter ended June 30, 2009 amounted to $78.7 million or $1.03 per diluted common share, compared to net income of $33.0 million or $0.25 per diluted common share for the quarter ended June 30, 2008. The Corporation s financial performance for the second quarter of 2009, as compared to the second quarter of 2008, was principally impacted by an increase of $193.8 million in the provision for loan and lease losses attributable to the migration of a substantial portion of loans to the substandard or doubtful category (including some considered as impaired), higher general reserves to account for increases in charge-offs and delinquency levels, specific reserves for additional loans classified as impaired during the second quarter of 2009 and the overall growth of the Corporation s loan portfolio and, to a lesser extent, by (i) an increase of $14.2 million in non-interest expenses driven primarily by non-controllable

Table of Contents

expenses, such as a charge of $8.9 million for the special assessment levied by the Federal Deposit Insurance Corporation (FDIC) and a $3.6 million increase in the regular deposit insurance premium, and (ii) a decrease of $3.6 million in net interest income adversely impacted by lower loan yields, resulting from a significant increase in non-accrual loans and the repricing of variable-rate construction and commercial loans tied to short-term indexes. These factors were partially offset by: (i) a net income tax benefit increase of $88.6 million resulting from lower taxable income and changes in enacted tax rates in Puerto Rico, and (ii) an increase of $11.4 million in non-interest income mainly related to a realized gain of $10.3 million on the sale of investment securities (mainly U.S. sponsored agency fixed-rate MBS) and an increase in gains from mortgage banking activities driven by a higher volume of loans sales and securitizations.

The highlights and key drivers of the Corporation s financial results for the quarter ended June 30, 2009 include the following:

Net interest income for the quarter ended June 30, 2009 was $131.0 million, compared to $134.6 million for the same period in 2008. The net interest spread and margin, on an adjusted tax equivalent basis, for the quarter ended June 30, 2009 were 2.60% and 2.92%, respectively, compared to 2.92% and 3.28%, respectively, for the same period in 2008. Net interest income was adversely impacted primarily by a significant increase in non-accrual loans and, to a lesser extent, the repricing of floating-rate commercial and construction loans at lower rates. Lower loan yields more than offset the benefit of lower short-term rates in the average cost of funding and the increase in average interest-earning assets. Refer to the Net Interest Income discussion below for additional information about, among other things, recent actions taken by the Corporation to restructure its investment portfolio.

For the second quarter of 2009, the Corporation s provision for loan and lease losses amounted to $235.2 million, compared to $41.3 million for the same period in 2008. Refer to the discussion under the Risk Management section below for an analysis of the allowance for loan and lease losses and non-performing assets and related ratios. The increase in the provision for 2009 was primarily due to: the migration of a substantial portion of loans to the substandard and doubtful categories (including some considered as impaired), thus requiring a higher reserve; changes in reserve factors used to determine the general reserve for the Corporation s construction, commercial and residential mortgage loan portfolios, in both the Puerto Rico and Florida portfolios, to account for higher charge-offs and delinquency levels; specific reserves necessary for additional loans classified as impaired during the second quarter of 2009; and the overall growth of the Corporation s loan portfolio.

The Corporation s net charge-offs for the second quarter of 2009 were $129.9 million or 3.85% of average loans on an annualized basis, compared to $29.5 million or 0.97% of average loans on an annualized basis for the same period in 2008. The increase in net charge-offs was primarily related to construction and commercial loans, in the Florida region. Refer to the Provision for Loan and Lease Losses and

Table of Contents

Risk Management Non-performing assets and Allowance for Loan and Lease Losses sections below for additional information.

For the quarter ended June 30, 2009, the Corporation s non-interest income amounted to $23.4 million, compared to $12.0 million for the quarter ended June 30, 2008. The increase was mainly due to a realized gain of $10.3 million on the sale of certain investments and a $1.6 million increase in gains from mortgage banking activities. During the second quarter of 2009, the Corporation completed the sale of approximately $242 million of U.S. agency MBS, realizing a gain of $9.4 million, and also sold its remaining exposure to auto industry corporate bonds of $1.5 million realizing a gain of $0.9 million in the process. Refer to the Non Interest Income discussion below for additional information.

Non-interest expenses for the second quarter of 2009 amounted to $96.0 million, compared to $81.8 million for the same period in 2008. The Corporation recorded $8.9 million in the second quarter of 2009 for the accrual of the special assessment levied by the FDIC. The FDIC special assessment, together with an increase of $3.6 million in the regular deposit insurance premium, resulted in an increase of over $12 million in FDIC assessments as compared to the second quarter of 2008. Other increases in non-interest expenses are mainly related to higher losses on real estate owned (REO) operations and an increase in property tax expense. Refer to the Non Interest Expenses discussion below for additional information.

For the second quarter of 2009, the Corporation recorded an income tax benefit of $98.1 million, compared to an income tax benefit of $9.5 million for the same period in 2008. The fluctuation is mainly related to increased deferred tax benefits due to net operating losses carryforward recorded as a result of current taxable losses and due to a lower current income tax provision resulting from lower taxable-income and adjustments to deferred tax asset, as a result of changes to the enacted rates in the Puerto Rico Internal Revenue Code of 1994, as amended (the PR Code). Refer to the Income Taxes discussion below for additional information.

Total assets as of June 30, 2009 amounted to $20.0 billion, an increase of $521.6 million compared to total assets as of December 31, 2008. The increase in total assets was primarily a result of an increase of $665.2 million in investment securities, partially offset by a decrease of $157.9 million in cash and cash equivalent funds used to pay down maturing borrowings. The Corporation increased its investment securities portfolio with the purchase of highly liquid securities, such as U.S. agency MBS and debt securities as well as U.S. Treasury investments. Refer to the Financial Condition and Operating Data discussion below for additional information.

As of June 30, 2009, total liabilities amounted to $18.2 billion, an increase of approximately $229.0 million, as compared to $17.9 billion as of December 31, 2008. The increase in total liabilities was mainly attributable to an increase of

$709.1 million in repurchase agreements, mainly new short-term repurchase agreements entered into to fund the growth of the investment portfolio, an increase of $400 million in advances from the Federal Home Loan Bank (FHLB) and the Federal Reserve (FED) and an increase of $171.7 million in core deposits, mainly in Puerto Rico. The aforementioned increases were partially offset by a decrease of approximately $1.2 billion in brokered CDs. Brokered certificates of deposit (CDs) with original maturities over 6 months and issued when interest rates were higher matured or were called during 2009 and current short-term rates on repurchase agreements and FHLB and FED advances provided a cost effective funding alternative. Refer to the Risk management Liquidity and Capital Adequacy discussion below for additional information about the Corporation s funding sources.

The Corporation s stockholders equity amounted to $1.8 billion as of June 30, 2009, an increase of $292.6 million compared to the balance as of December 31, 2008, driven by the $400 million investment by the United States Department of the Treasury (the U.S. Treasury) in preferred stock of the Corporation through the U.S. Treasury Troubled Asset Relief Program (TARP) Capital Purchase Program. Partially offsetting this increase was the net loss of $56.8 million incurred in the first half of 2009, dividends amounting to $39.7 million for the first half of 2009 ($13.0 million in common stock, or $0.14 per share, and $26.7 million in preferred stock), and a decrease of $11.0 million in accumulated other comprehensive income. Refer to the Risk Management Capital section below for additional information.

Total loan production, including purchases, for the quarter ended June 30, 2009 was $900.4 million, compared to $1.0 billion for the comparable period in 2008. The decrease in loan production during 2009, as compared to the second quarter of 2008, was mainly associated with a reduced volume of commercial loan originations in Puerto Rico, adversely impacted by deteriorated economic conditions and a lower overall demand for all types of loans.

Total non-performing assets as of June 30, 2009 were $1.3 billion, compared to $637.2 million as of December 31, 2008. The increase in non-performing assets since December 31, 2008 was led by an increase of $367.8 million in loans classified as non-performing in the state of Florida, mainly construction loans, an increase of $97.7 million in non-performing residential mortgage loans in Puerto Rico, an increase of $85.0 million in non-performing construction loans in Puerto Rico and an increase of $41.3 million in non-performing commercial loans in Puerto Rico. Also, during the second quarter of 2009, the Corporation classified as non-performing investment securities with a book value of $64.5 million that were pledged to Lehman Brothers Special Financing, Inc., in connection with several interest rate swap agreements entered into with that institution. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation decided to classify such investments as non-performing. Other increases in non-performing assets mainly consist of additions to

repossessed properties, mainly additions to the real estate owned portfolio, which increased by $20.8 million. Partially offsetting the aforementioned increases was a decrease of $5.2 million in non-performing consumer loans (including finance leases) in Puerto Rico. Refer to the Risk Management Non-accruing and Non-performing Assets section below for additional information.

CRITICAL ACCOUNTING POLICIES AND PRACTICES

The accounting principles of the Corporation and the methods of applying these principles conform with generally accepted accounting principles in the United States (GAAP) and to general practices within the banking industry. The Corporation s critical accounting policies relate to the 1) allowance for loan and lease losses; 2) other-than-temporary impairments; 3) income taxes; 4) classification and related values of investment securities; 5) valuation of financial instruments; 6) derivative financial instruments; and 7) income recognition on loans. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the recorded assets and liabilities and contingent assets and liabilities disclosed 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 have 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 Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp s 2008 Annual Report on Form 10-K. There have not been any material changes in the Corporation s critical accounting policies since December 31, 2008, except for changes in the Other-than-Temporary Impairment (OTTI) model for debt securities as required by the Financial Accounting Standards Board Staff Position No. (FSP) FAS 115-2 and FAS 124-2 which the Corporation adopted during the second quarter of 2009. Refer to Note 4 of the accompanying unaudited consolidated financial statements for additional information about the adoption of FSP FAS 115-2 and FAS 124-2.

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 re-pricing and maturity mismatch of the Corporation s assets and liabilities. Net interest income for the quarter and six-month period ended June 30, 2009 was $131.0 million and $252.6 million, respectively, compared to $134.6 million and $259.1 million, respectively, for the comparable periods in 2008. On a tax equivalent basis and excluding the changes in the fair value of derivative instruments and unrealized gains and losses on liabilities elected

Table of Contents

to be measured at fair value under SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, net interest income for the quarter and six-month period ended June 30, 2009 was $142.6 million and $275.0 million, respectively, compared to $144.5 million and $275.8 million, respectively, for the comparable periods of 2008.

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 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 a tax equivalent basis (for definition and reconciliation of this non-GAAP measure, refer to discussions below) and excluding: (1) the change in the fair value of derivative instruments and (2) unrealized gains or losses on SFAS 159 liabilities.

Table of Contents

Part I

Quarter ended June 30,	Average Volume 2009	Average Volume 2008	Interest income [1] / expense 2009	Interest income [1] / expense 2008	Average Rate [1] 2009	Average Rate [1] 2008
			(Dollars in thousands)			
Interest-earning assets:						
Money market & other short-term investments	$ 101,819	$ 374,559	$ 117	$ 1,813	0.46%	1.95%
Government obligations [2]	1,540,821	1,303,468	15,904	20,566	4.14%	6.35%
Mortgage-backed securities	4,322,708	3,806,115	60,012	58,034	5.57%	6.13%
Corporate bonds	7,458	6,103	202	141	10.86%	9.29%
FHLB stock	86,509	66,703	788	1,140	3.65%	6.87%
Equity securities	1,977	4,183	18		3.65%	0.00%
Total investments [3]	6,061,292	5,561,131	77,041	81,694	5.10%	5.91%
Residential real estate loans	3,425,235	3,308,950	51,717	54,239	6.06%	6.59%
Construction loans	1,626,141	1,475,995	13,142	20,745	3.24%	5.65%
Commercial loans	6,423,055	5,379,906	66,801	73,461	4.17%	5.49%
Finance leases	347,732	376,007	7,111	8,108	8.20%	8.67%
Consumer loans	1,678,057	1,613,563	47,436	46,479	11.34%	11.59%
Total loans [4] [5]	13,500,220	12,154,421	186,207	203,032	5.53%	6.72%
Total interest-earning assets	$ 19,561,512	$ 17,715,552	$ 263,248	$ 284,726	5.40%	6.46%
Interest-bearing liabilities:						
Brokered CDs	$ 7,051,179	$ 7,373,267	$ 56,677	$ 72,218	3.22%	3.94%
Other interest-bearing deposits	4,146,552	3,671,865	23,443	26,077	2.27%	2.86%
Loans payable	768,505		614		0.32%	0.00%
Other borrowed funds	3,862,885	3,724,955	31,646	32,351	3.29%	3.49%
FHLB advances	1,450,478	1,151,861	8,317	9,572	2.30%	3.34%
Total interest-bearing liabilities [6]	$ 17,279,599	$ 15,921,948	$ 120,697	$ 140,218	2.80%	3.54%
Net interest income			$ 142,551	$ 144,508		
Interest rate spread					2.60%	2.92%
Net interest margin					2.92%	3.28%

Average Volume **Average Rate [1]**

Six-Month Period Ended June 30,	2009	2008	Interest income [1] / expense 2009	2008	2009	2008
			(Dollars in thousands)			
Interest-earning assets:						
Money market & other short-term investments	$ 108,314	$ 402,774	$ 208	$ 5,072	0.39%	2.53%
Government obligations [2]	1,341,934	1,786,011	35,505	57,711	5.34%	6.50%
Mortgage-backed securities	4,288,731	3,102,385	123,433	92,025	5.80%	5.97%
Corporate bonds	7,584	6,185	235	282	6.25%	9.17%
FHLB stock	78,856	64,274	1,148	2,261	2.94%	7.07%
Equity securities	2,167	4,186	36	11	3.35%	0.53%
Total investments [3]	5,827,586	5,365,815	160,565	157,362	5.56%	5.90%
Residential real estate loans	3,460,647	3,249,913	105,766	105,959	6.16%	6.56%
Construction loans	1,586,125	1,474,252	27,244	44,465	3.46%	6.07%
Commercial loans	6,267,792	5,301,551	130,946	158,901	4.21%	6.03%
Finance leases	353,969	377,004	14,693	16,396	8.37%	8.75%
Consumer loans	1,701,580	1,633,598	96,030	94,535	11.38%	11.64%
Total loans [4] [5]	13,370,113	12,036,318	374,679	420,256	5.65%	7.02%
Total interest-earning assets	$ 19,197,699	$ 17,402,133	$ 535,244	$ 577,618	5.62%	6.67%
Interest-bearing liabilities:						
Brokered CDs	$ 7,255,053	$ 7,286,442	$ 129,510	$ 157,921	3.60%	4.38%
Other interest-bearing deposits	4,087,541	3,492,825	48,635	52,350	2.40%	3.03%
Loans payable	534,331		960		0.36%	0.00%
Other borrowed funds	3,609,918	3,697,892	64,568	70,845	3.61%	3.85%
FHLB advances	1,496,949	1,109,465	16,609	20,720	2.24%	3.76%
Total interest-bearing liabilities [6]	$ 16,983,792	$ 15,586,624	$ 260,282	$ 301,836	3.09%	3.89%
Net interest income			$ 274,962	$ 275,782		
Interest rate spread					2.53%	2.78%
Net interest margin					2.89%	3.19%

(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 Puerto Rico statutory tax rate as adjusted for recent changes to enacted tax rates

Table of Contents

(40.95% for the Corporation s subsidiaries other than IBEs in 2009, 35.95% for the Corporation s IBEs in 2009 and 39% for all subsidiaries in 2008)) 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 derivative and unrealized gains or losses on SFAS 159

liabilities 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 in available-for-sale securities are excluded from the average volumes.

(4) Average loan balances include the average of non-accruing loans.

(5) Interest income on loans includes $2.7 million and $2.9 million for the second quarter of 2009 and 2008, respectively, and $5.5 million and $5.4 million for the six-month period ended June 30, 2009 and 2008, respectively, of income from prepayment penalties and late fees related to the Corporation s loan portfolio.

(6) Unrealized gains and losses on SFAS 159 liabilities are excluded from the average volumes.

Part II

	Quarter ended June 30, 2009 compared to 2008 Increase (decrease) Due to:			**Six-month period ended June 30, 2009 compared to 2008 Increase (decrease) Due to:**		
	Volume	**Rate**	**Total**	**Volume**	**Rate**	**Total**
		(In thousands)			(In thousands)	
Interest income on interest-earning assets:						
Money market & other short-term investments	$ (828)	$ (868)	$ (1,696)	$ (2,253)	$ (2,611)	$ (4,864)
Government obligations	3,146	(7,808)	(4,662)	(12,661)	(9,545)	(22,206)
Mortgage-backed securities	7,632	(5,654)	1,978	34,647	(3,239)	31,408
Corporate bonds	35	26	61	54	(101)	(47)
FHLB stock	263	(615)	(352)	367	(1,480)	(1,113)
Equity securities		18	18	(20)	45	25
Total investments	10,248	(14,901)	(4,653)	20,134	(16,931)	3,203
Residential real estate loans	1,917	(4,439)	(2,522)	6,554	(6,747)	(193)
Construction loans	1,709	(9,312)	(7,603)	2,675	(19,896)	(17,221)
Commercial loans	12,711	(19,371)	(6,660)	24,631	(52,586)	(27,955)
Finance leases	(578)	(419)	(997)	(1,000)	(703)	(1,703)
Consumer loans	1,910	(953)	957	3,775	(2,280)	1,495
Total loans	17,669	(34,494)	(16,825)	36,635	(82,212)	(45,577)
Total interest income	27,917	(49,395)	(21,478)	56,769	(99,143)	(42,374)
Interest expense on interest-bearing liabilities:						
Brokered CDs	(3,012)	(12,529)	(15,541)	(671)	(27,740)	(28,411)
Other interest-bearing deposits	3,099	(5,733)	(2,634)	8,154	(11,869)	(3,715)
Loan payable	614		614	960		960
Other borrowed funds	1,199	(1,904)	(705)	(1,718)	(4,559)	(6,277)
FHLB advances	2,117	(3,372)	(1,255)	5,809	(9,920)	(4,111)
Total interest expense	4,017	(23,538)	(19,521)	12,534	(54,088)	(41,554)

Change in net interest income	$ 23,900	$ (25,857)	$ (1,957)	$ 44,235	$ (45,055)	$ (820)

A portion 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 are tax-exempt under the Puerto Rico tax law (Refer to the Income Taxes discussion below for additional information regarding recent legislation that imposes a temporary 5% tax rate on IBEs net income). To facilitate the comparison of all interest data related to these assets, the interest income has been converted to a 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 recent changes to enacted tax

Table of Contents

rates (40.95% for the Corporation s subsidiaries other than IBEs in 2009, 35.95% for the Corporation s IBEs in 2009 and 39% for all subsidiaries in 2008)) and adding to it the cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law. An increase in revenues was observed in connection with the increase in volume and interest rate spread in tax-exempt MBS held by the Corporation s IBEs. Refer to the Income Taxes discussion below for additional information of the Puerto Rico tax law.

The presentation of net interest income excluding the effects of the changes in the fair value of the derivative instruments and unrealized gains or losses on SFAS 159 liabilities 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 and unrealized gains or losses on SFAS 159 liabilities 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 the interest income on an adjusted tax equivalent basis set forth in Part I above to interest income set forth in the Consolidated Statements of (Loss) Income:

	Quarter Ended June 30,		**Six-month period ended June 30,**	
(In thousands)	**2009**	**2008**	**2009**	**2008**
Interest income on interest-earning assets on an adjusted tax equivalent basis	$ 263,248	$ 284,726	$ 535,244	$ 577,618
Less: tax equivalent adjustments	(13,933)	(13,761)	(28,381)	(22,843)
Plus: net unrealized gain on derivatives	3,465	5,643	4,240	920
Total interest income	$ 252,780	$ 276,608	$ 511,103	$ 555,695

The following table summarizes the components of the changes in fair values of interest rate swaps and interest rate caps, which are included in interest income.

	Quarter Ended June 30,		**Six-month period ended June 30,**	
(In thousands)	**2009**	**2008**	**2009**	**2008**
Unrealized gain on derivatives (economic undesignated hedges):				
Interest rate caps	$ 2,628	$ 3,095	$ 2,850	$ 880
Interest rate swaps on loans	837	2,548	1,390	40
Net unrealized gain on derivatives (economic undesignated hedges)	$ 3,465	$ 5,643	$ 4,240	$ 920

Table of Contents

The following table summarizes the components of interest expense for the quarters and six-month periods ended June 30, 2009 and 2008. As previously stated, the net interest margin analysis excludes the changes in the fair value of derivatives and unrealized gains or losses on SFAS 159 liabilities.

	Quarter ended June 30,		Six-month period ended June 30,	
(In thousands)	2009	2008	2009	2008
Interest expense on interest-bearing liabilities	$ 116,481	$ 148,867	$ 253,635	$ 314,704
Net interest realized on interest rate swaps	(847)	(12,905)	(5,499)	(19,947)
Amortization of placement fees on brokered CDs	5,063	4,256	12,146	7,079
Interest expense excluding net unrealized loss (gain) on derivatives (economic undesignated hedges) and net unrealized (gain) loss on SFAS 159 liabilities	120,697	140,218	260,282	301,836
Net unrealized loss (gain) on derivatives (economic undesignated) and SFAS 159 liabilities	1,069	1,784	(1,791)	(5,205)
Total interest expense	$ 121,766	$ 142,002	$ 258,491	$ 296,631

The following table summarizes the components of the net unrealized gain and loss on derivatives (economic undesignated hedges) and net unrealized gain and loss on SFAS 159 liabilities which are included in interest expense.

	Quarter ended June 30,		Six-month period ended June 30,	
	2009	2008	2009	2008
(In thousands)				
Unrealized loss (gain) on derivatives (economic undesignated hedges):				
Interest rate swaps and other derivatives on brokered CDs	$ 892	$ 29,934	$ 5,318	$ (25,402)
Interest rate swaps and other derivatives on medium-term notes	53	314	163	1
Net unrealized loss (gain) on derivatives (economic undesignated hedges)	$ 945	$ 30,248	$ 5,481	$ (25,401)
Unrealized (gain) loss on SFAS 159 liabilities:				
Unrealized (gain) loss on brokered CDs	(1,555)	(28,462)	(8,696)	21,095
Unrealized loss (gain) on medium-term notes	1,679	(2)	1,424	(899)
Net unrealized loss (gain) on SFAS 159 liabilities	$ 124	$ (28,464)	$ (7,272)	$ 20,196

Net unrealized loss (gain) on derivatives (economic undesignated hedges) and SFAS 159 liabilities	$ 1,069	$ 1,784	$ (1,791)	$ (5,205)

Interest income on interest-earning assets primarily represents interest earned on loans receivable 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 FED and notes payable.

Net interest incurred or realized on interest rate swaps primarily represents net interest exchanged on pay-float swaps that economically hedge brokered CDs and medium-term notes.

The amortization of broker placement fees represents the amortization of fees paid to brokers upon issuance of related financial instruments (i.e., brokered CDs not elected for the fair value option under SFAS 159).

Table of Contents

Unrealized gains or losses on derivatives represent changes in the fair value of derivatives, primarily interest rate swaps, that economically hedge liabilities (i.e., brokered CDs and medium-term notes) or assets (i.e., loans and investments).

Unrealized gains or losses on SFAS 159 liabilities represent the change in the fair value of such liabilities (medium-term notes and brokered CDs), other than the accrual of interests, for which the Corporation elected the fair value option under SFAS 159.

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 June 30, 2009, most of the interest rate swaps outstanding are used for protection against rising interest rates. In the past, the volume of interest rate swaps was much higher, as they were used to convert the fixed-rate of a large portfolio of brokered CDs, mainly those with long-term maturities, to a variable rate and mitigate the interest rate risk related to variable rate loans. However, most of these interest rate swaps were called during 2009, in the face of lower interest rate levels. Refer to Note 8 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 decreased 3% to $131.0 million for the second quarter of 2009 from $134.6 million in the second quarter of 2008 and by 2% to $252.6 million for the first six months of 2009 from $259.1 million in the first half of 2008. Net interest income was adversely impacted primarily by a significant increase in non-accrual loans and, to a lesser extent, the repricing of floating-rate commercial and construction loans at lower rates. Net interest margin on an adjusted tax-equivalent basis decreased from 3.28% for the second quarter of 2008 to 2.92% for the second quarter of 2009 and from 3.19% for the first half of 2008 to 2.89% for the first half of 2009. Lower loan yields more than offset the benefit of lower short-term rates in the average cost of funding and the increase in average interest-earning assets. The weighted-average yield on loans on a tax-equivalent basis decreased from 6.72% for the second quarter of 2008 to 5.53% for the second quarter of 2009 and from 7.02% for the first half of 2008 to 5.65% for the first half of 2009. The target for the Federal Funds rate was lowered between 200 and 225 basis points from March 31, 2008 to June 30, 2009, the Prime Rate dropped to 3.25% from 5.25% as of March 31, 2008, and the 3-month LIBOR decreased to 0.595% from 2.69% as of March 31, 2008 adversely affecting the interest income from the variable-rate construction and commercial loans tied to short-term indexes, which was exacerbated by the significant increase of over $700 million in non-performing loans since June 30, 2008 (refer to Risk Management Non-accruing and Non-performing Assets section below for additional information about non-performing loans levels). The Corporation is

currently originating loans and renegotiating existing ones at higher credit spreads to account for inherent risks in the current economy. Such actions are positively impacting net interest income. Lower yields were also observed in the investment securities portfolio, driven by the high level of MBS prepayments and the approximately $940 million U.S. agency debentures called since June 30, 2008. Partially offsetting the decline in earning assets yields were lower funding costs and an increase in average earning assets. The decrease in the Corporation s average cost of funds is related to the current low level of short-term interest rates as well as the change in the mix of funding sources. Brokered certificates of deposit (CDs) with original maturities over 6 months and issued when interest rates were higher matured, or were called during 2009, and current short-term rates on repurchase agreements and FHLB and FED advances provided a cost effective funding alternative. Since being approved to participate during the first quarter of 2009 in the Borrower-in-Custody Program (BIC) of the FED, the Corporation has taken advantage of that alternative funding channel. Through the BIC program, a broad range of loans (including commercial, consumer and mortgages) are pledged as collateral for borrowings at the FED Discount Window. The Corporation has increased its use of this low-cost source of funding, and as of June 30, 2009, the Corporation had approximately $514 million of available credit through the BIC program. Also, the current low interest rate levels made available the issuance of new short-term brokered CDs at rates significantly lower than those that matured. For the six-month period ended June 30, 2009, the Corporation issued $3.3 billion in brokered CDs at an average rate of 1.01% (including the rollover of short-term brokered CDs and replacement of brokered CDs called) with a weighted-average maturity of 6 months. The Corporation increased its short-term borrowing as a measure of interest rate risk management to match the shortening in the average life of the investment portfolio, as discussed below, and has been reducing the pricing of its core deposits given current market rates.

Average earning assets for the second quarter and first half of 2009 increased by $1.8 billion, as compared to comparable periods in 2008. The increase was driven by commercial and residential real estate loan originations, including the $500 million facility extended to the Puerto Rico Sales Tax Financing Corp. (COFINA under its Spanish acronym), an instrumentality of the Government of Puerto Rico, that was outstanding for almost the entire second quarter of 2009 until it was paid off on June 18, 2009. Also, funds obtained through short-term borrowings as well as proceeds from sales and prepayments of MBS were invested, in part, in the purchase of investment securities to offset declining securities yields due to the acceleration of MBS prepayments and calls of approximately $937 million of U.S. agency debentures in 2009. The average volume of investment securities increased by $500.2 million for the second quarter of 2009, as compared to the second quarter of 2008, and by $461.8 million for the first half of 2009 compared to the first half of 2008. Purchases of investment securities for the first half of 2009 (mainly U.S. agency callable securities with contractual maturities of 2-3 years and 15 year U.S. government sponsored agencies MBS) were financed with very low-cost of sources of funding, thus protecting interest margins.

On an adjusted tax equivalent basis, net interest income decreased by $2.0 million, or 1%, for the second quarter of 2009 compared to the same period in 2008 and by $0.8 million for the first half of 2009 compared to the first half of 2008. The decrease was

Table of Contents

principally due to the lower yields on earning assets as described above, partially offset by a $0.2 million increase in the tax-equivalent adjustment as compared to the second quarter of 2008 and by a $5.5 million increase in the tax-equivalent adjustment for the first half of 2009 as compared to the same period in 2008. The tax-equivalent adjustment increases interest income on tax-exempt securities and loans by an amount which makes tax-exempt income comparable, on a pre-tax basis, to the Corporation s taxable income as previously stated. The increase in the tax-equivalent adjustment was mainly related to increases in the interest rate spread on tax-exempt assets, mainly MBS held by the Corporation s IBE subsidiary, FirstBank Overseas Corporation, resulting from the overall decrease in the cost of funding.

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 and six-month period ended on June 30, 2009, the Corporation provided $235.2 million and $294.6 million, respectively, for loan and lease losses as compared to $41.3 million and $87.1 million, respectively, for the comparable periods in 2008. 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 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.

Table of Contents

Non-Interest Income

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Other service charges on loans	$ 1,523	$ 1,418	$ 3,052	$ 2,731
Service charges on deposit accounts	3,327	3,191	6,492	6,555
Mortgage banking activities	2,373	804	3,179	1,123
Rental income	407	579	856	1,122
Insurance income	2,229	2,551	4,599	5,279
Other operating income	4,312	4,138	8,596	9,058
Non-interest income before net gain on investments	14,171	12,681	26,774	25,868
Gain on VISA shares				9,342
Net gain on sale of investments	10,305	(190)	28,143	6,661
OTTI on equity securities		(489)	(388)	(489)
OTTI on debt securities	(1,061)		(1,061)	
Net gain on investments	9,244	(679)	26,694	15,514
Total	$ 23,415	$ 12,002	$ 53,468	$ 41,382

Non-interest income primarily consists of other service charges on loans; service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains and losses on mortgage banking activities; and net gains and losses on investments and impairments.

Other service charges on loans consist mainly of service charges on credit card-related activities and other non-deferrable fees.

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

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

Rental income represents income generated by the Corporation s subsidiary, First Leasing and Rental Corporation, on the rental of various types of motor vehicles.

Insurance income consists of insurance commissions earned by the Corporation s subsidiary FirstBank Insurance Agency, Inc., and the Bank s subsidiary in the U.S. Virgin Islands, FirstBank Insurance V.I., Inc. These subsidiaries offer a wide variety of insurance business.

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.

Table of Contents

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 impairment charges on the Corporation s investment portfolio.

Non-interest income increased to $23.4 million for the second quarter of 2009 from $12.0 million for the second quarter of 2008 and increased to $53.5 million for the first half of 2009 compared to $41.4 million for the first half of 2008. The increase was related to gains from a higher volume of sales of investment securities and higher gains from mortgage banking activities. A realized gain of $10.3 million and $28.1 million was recorded in the second quarter and first half of 2009, respectively, on the sale of investment securities (mainly U.S. agency MBS), compared to a realized loss of $0.2 million and a realized gain of $6.7 million, respectively, for the comparable periods in 2008. During the second quarter of 2009, the Corporation completed the sale of approximately $342 million ($763 million for the first half of 2009) of investment securities (mainly U.S agency MBS), realizing a gain of $9.4 million ($27.2 million for the first half of 2009), and also sold its remaining exposure to auto industry corporate bonds of $1.5 million realizing a gain of $0.9 million in the process. A high prepayment scenario for MBS is anticipated through the rest of the year. Given this outlook, and the fact that certain available-for-sale securities were trading at a substantial premium over par, the Corporation continued to re-structure its investment portfolio, rather than wait for the MBS to be pre-paid at par, which has resulted in the realization of gains on sales. The impact of realized gains on sale of MBS securities was partially offset, when compared to the first half of 2008, by the $9.3 million gain recorded in the first quarter of 2008 on the mandatory redemption of a portion of the Corporation s investment in VISA as part of VISA s Initial Public Offering.

A $1.6 million increase in gains from mortgage banking activities for the second quarter of 2009, as compared to the second quarter of 2008, and of $2.1 million for the first half of 2009 as compared to the first half of 2008 contributed to higher net interest income and was driven by a higher volume of loan sales and securitizations. Servicing rights recorded for loan sales and securitizations during the second quarter and first half of 2009 amounted to $2.0 million and $3.1 million, respectively, compared to $0.2 million and $0.5 million, respectively, for the comparable periods in 2008. During the second quarter and first half of 2009, and for the first time in many years, the Corporation completed the securitization of approximately $114 million and $188 million, respectively, of FHA/VA mortgage loans into GNMA MBS.

Partially offsetting the aforementioned increases in non-interest income were OTTI charges on debt securities of approximately $1.1 million recorded in the second quarter of 2009. The Corporation adopted FSP FAS 115-2 and FAS 124-2 in the second quarter of 2009. This FSP amended the OTTI model for debt securities. Under the new guidance, OTTI loss 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

Table of Contents

a debt security, it must evaluate expected cash flows to be received and record in earnings any credit loss that has occurred.

Debt securities issued by U.S. Government agencies, government sponsored entities and the U.S. Treasury accounted for more than 95% of the total available-for-sale and held-to-maturity portfolio as of June 30, 2009 and do not have any credit losses, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation s assessment was concentrated mainly on the approximately $130 million private label MBS which the Corporation evaluates for credit losses on a quarterly basis. The Corporation recorded a $1.1 million OTTI loss (net of a payment received of $4.2 million) through earnings in the second quarter of 2009 that represents the credit loss of available-for-sale private label MBS. During the second quarter of 2009, the Corporation received from R&G Financial Corporation (R&G), a Puerto Rican financial institution, a payment of $4.2 million to eliminate the 10% recourse provision contained in the private label MBS. The elimination of the recourse provision was the reason for which the present value of the expected future cash flows in these private label MBS is less than the amortized cost of the security. The non-credit component of the unrealized loss was $31.5 million as of June 30, 2009, which was recorded in comprehensive income. 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, thus contributing to the decrease in non-interest income. Refer to Note 4 of the accompanying unaudited consolidated financial statements for additional information.

With respect to equity securities, no OTTI loss was recorded during the second quarter of 2009, compared to a charge of $0.5 million for the second quarter of 2008. OTTI loss for equity securities of $0.4 million was recorded for the first half of 2009 compared to a charge of $0.5 million for the first half of 2008. The remaining carrying amount of available-for-sale equity securities as of June 30, 2009 amounted to $0.5 million.

Fee income from deposit accounts and non-deferrable loan fees remained stable. Despite an increase in the deposit base, service charges on deposits remained stable as a result of the decrease in the volume of transactions that require service charges. Customers engaged in fewer transactions because of the current economic environment.

Non-Interest Expenses

The following table presents the detail of non-interest expenses for the periods indicated:

	Quarter Ended June 30,		Six-month Period Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Employees compensation and benefits	$ 34,472	$ 34,994	$ 68,714	$ 71,320
Occupancy and equipment	14,824	15,541	29,598	30,520
Deposit insurance premium	14,895	2,345	19,775	4,691
Other taxes, insurance and supervisory fees	8,368	5,588	14,161	11,252
Professional fees recurring	3,138	3,620	5,961	8,180
Professional fees non-recurring	204	1,299	567	1,798
Servicing and processing fees	2,246	2,381	4,558	4,969
Business promotion	3,836	4,802	6,952	9,067
Communications	2,018	2,250	4,145	4,523
Net loss on REO operations	6,626	3,172	12,001	6,428
Other	5,361	5,771	14,084	11,202
	$ 95,988	$ 81,763	$ 180,516	$ 163,950

Non-interest expenses increased to $96.0 million for the second quarter of 2009 from $81.8 million for the second quarter of 2008 and increased to $180.5 million for the first half of 2009 compared to $164.0 million for the first half of 2008. The Corporation recorded $8.9 million in the second quarter of 2009 for the accrual of the special assessment levied by the FDIC. The FDIC special assessment, together with an increase in the regular deposit insurance premium, resulted in an increase of over $12 million for the second quarter and over $15 million for the first half in FDIC assessments as compared to 2008. The final FDIC assessment rule establishes a special assessment of five basis points on each FDIC-insured depository institution s assets, minus its Tier 1 capital, as of June 30, 2009. The special assessment will be collected on September 30, 2009. The special assessment is assessed against assets minus Tier 1 capital rather than domestic deposits, but the assessment is capped at 10 basis points of an institution s domestic deposits so that no institution will pay an amount higher than they would have paid under the interim rule.

Property tax expenses were higher by approximately $2.6 million for the second quarter of 2009, compared to the second quarter of 2008 and for the first half of 2009 compared to the first half of 2008, mainly attributable to accruals for the reassessed value of certain properties.

Losses on REO operations amounted to $6.6 million for the second quarter of 2009, compared to $3.2 million for the second quarter of 2008, and amounted to $12.0 million for the first half of 2009 compared to $6.4 million for the first half of 2008. Among the components of these increasing losses are expenses incurred in REO insurance, taxes and maintenance associated with a higher inventory and write-downs of the value of repossessed properties due to declining real estate prices, including a $1.5 million write-down during the second quarter of 2009 relating to a foreclosed condo-conversion project in the U.S. mainland.

Also contributing to higher non-interest expenses for the first half of 2009 was a $4.0 million impairment of the core deposit intangible of FirstBank Florida. The core deposit intangible represents the value of the premium paid to acquire core deposits of an institution. Upon the acquisition of FirstBank Florida in 2005, the Corporation recorded a core deposit intangible of $17.3 million. The amortized book value of $11.7 million was evaluated and the evaluation calculated an estimated value of $7.3 million under SFAS 144, Accounting

for the Impairment or Disposal of Long-Lived Assets. This non-cash impairment charge, attributable to decreases in the base of core deposits acquired, does not affect the Corporation s cash balances, liquidity or operations. Moreover, the charge did not have a negative impact on the Corporation s tangible capital and regulatory capital ratios.

The Corporation had reductions in all other operating expenses, as compared to 2008, including a decrease of $1.6 million for the quarter and $3.5 million for the first half in professional service fees, a decrease of $1.0 million for the quarter and $2.1 million for the first half in business promotion expenses, a decrease of $0.7 million for the quarter and $0.9 for the first half in occupancy and equipment expenses and a decrease of $0.5 million for the quarter and $2.6 million for the first half in employees compensation and benefit expenses. The Corporation has been able to continue the growth of its operations without incurring substantial additional operating expenses and is committed to its Business Rationalization program, which includes revenue generating and cost-cutting initiatives.

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 creditable, within certain conditions and limitations, against the Corporation s Puerto Rico tax liability. The Corporation is also subject to U.S. Virgin Islands taxes on its income from sources within that jurisdiction. Any such tax paid is creditable against the Corporation s Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 1994, as amended (PR Code), First BanCorp is subject to a maximum statutory tax rate of 39%. In 2009 the Puerto Rico Government approved Act No. 7 (the Act), to stimulate Puerto Rico s economy and to reduce the Puerto Rico Government s fiscal deficit. The Act imposes a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which is applicable to corporations, among others, whose combined income exceeds $100,000, effectively resulting in an increase in the maximum statutory tax rate from 39% to 40.95%. This temporary measure is effective for tax years that commenced after December 31, 2008 and before January 1, 2012. The PR Code also includes an alternative minimum tax of 22% that applies if the Corporation s regular income tax liability is less than the alternative minimum tax requirements.

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 International Banking Entities (IBEs) of the Corporation and the Bank and through the Bank s subsidiary FirstBank Overseas Corporation, in which the interest income and gain

on sales is exempt from Puerto Rico and U.S. income taxation. Under the Act, all IBEs are subject to a special 5% tax on their net income not otherwise subject to tax pursuant to the PR Code. This temporary measure is also effective for tax years that commence after December 31, 2008 and before January 1, 2012. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for a total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs net income exceeds 20% of the bank s total net taxable income.

For the quarter and six-month period ended June 30, 2009, the Corporation recognized an income tax benefit of $98.1 million and $112.3 million, respectively, compared to an income tax benefit of $9.5 million and $17.2 million, respectively, recorded for the same periods in 2008. The positive fluctuation in the financial results was mainly related to increased deferred tax benefits due to net operating losses carryforward recorded as a result of current taxable losses and due to lower taxable income and adjustments to deferred tax asset, as a result of the aforementioned changes to the PR Code enacted tax rates. The Corporation recorded an additional income tax benefit of $1.6 million and $6.0 million for the quarter and six-month period ended June 30, 2009, respectively, in connection with changes to enacted tax rates, net of a $1.8 million and $3.6 million provision for the quarter and six-month period ended June 30, 2009, respectively, recorded for the operations of FirstBank Overseas Corporation. Deferred tax amounts have been adjusted for the effect of the tax rate expected to apply to taxable income in the period in which the deferred tax asset or liability is expected to be settled or realized.

As of June 30, 2009, the Corporation evaluated its ability to realize the deferred tax asset and concluded, based on the evidence available, that it is more likely than not that some of the deferred tax asset will not be realized and, thus, established a valuation allowance of $5.5 million, compared to a valuation allowance of $7.3 million as of December 31, 2008. As of June 30, 2009, the deferred tax asset, net of the valuation allowance of $5.5 million, amounted to approximately $217.8 million compared to $128.0 million, net of the valuation allowance of $7.3 million as of December 31, 2008.

In July 2009, the Corporation entered into an agreement with the Puerto Rico Department of the Treasury to conclude an income tax investigation and to eliminate all possible income and withholding tax deficiencies related to taxable years 2005, 2006, 2007 and 2008. As a result of such agreement, the Corporation will reverse during the third quarter of 2009 the remaining Unrecognized Tax Benefit (UTBs) and related interest by approximately $2.9 million, net of the payment made to the Puerto Rico Department of the Treasury in connection with the conclusion of the tax investigation. Refer to Note 17 to the accompanying notes to the unaudited interim consolidated financial statements for additional information.

Table of Contents

FINANCIAL CONDITION AND OPERATING DATA ANALYSIS

Loan Production

First BanCorp relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage loan originations with wholesale servicing released mortgage loan purchases from mortgage bankers. The Corporation manages its construction and commercial loan originations through a centralized unit and most of its originations come from existing customers as well as through referrals and direct solicitations. For commercial loan originations, the Corporation also has regional offices to provide services to designated territories.

Total loan production, including purchases, for the quarter and six-month period ended June 30, 2009 was $900.4 million and $2.2 billion, respectively, compared to $1.0 billion and $2.1 billion, respectively, for the comparable periods in 2008. The decrease in loan production for the second quarter of 2009, as compared to the second quarter of 2008, was mainly associated with lower commercial loan originations in Puerto Rico adversely affected by deteriorated economic conditions. Meanwhile, the slight increase for the first half of 2009, as compared to the first half of 2008, is mainly attributable to the $500 million facility extended to COFINA. Despite the present economic climate, the Corporation s residential mortgage loan originations, including purchases of approximately $58.7 million for the quarter and $117.4 million for the first half, amounted to $181.1 million and $323.9 million for the second quarter and six-month period ended June 30, 2009, respectively. Approximately 50% of the residential mortgage loan originations in Puerto Rico during 2009 consisted of conforming mortgage loans. The aforementioned figures exclude the purchase of approximately $205 million of residential mortgage loans that previously served as collateral for a commercial loan extended to R&G, as discussed below, since the Corporation believes this approach provides a better representation of the Corporation s residential mortgage loan production capacity.

The following table details First BanCorp s loan production for the periods indicated:

	Quarter Ended June 30,		Six-month Period Ended June 30,	
	2009	2008	2009	2008
	(In thousands)			
Residential real estate	$ 181,082	$ 205,542	$ 323,938	$ 391,360
Commercial and construction	570,461	652,884	1,550,479	1,337,874
Finance leases	20,228	28,784	39,822	58,086
Consumer	128,643	140,064	253,038	277,637
Total loan production	$ 900,414	$ 1,027,274	$ 2,167,277	$ 2,064,957

Residential Real Estate Loans

Residential loan production for the second quarter and first half of 2009 decreased by $24.5 million, or 12%, and $67.4 million, or 17%, respectively, compared to the same periods in 2008. These loans are mainly fully amortizing fixed-rate loans and the

decrease is mainly related to a slowing real estate market due to deteriorated economic conditions.

The Corporation has not been active in subprime or adjustable rate mortgage loans (ARMs), nor has it been exposed to collateral debt obligations or other types of exotic products that aggravated the current global financial crisis. More than 90% of the Corporation s outstanding balance in its residential mortgage loan portfolio consists of fixed-rate, fully amortizing, full documentation loans.

Commercial and Construction Loans

Commercial and construction loan production for the second quarter of 2009 decreased by $82.4 million, or 13%, compared to the same period in 2008. The decrease is mainly associated with lower commercial loans originations in Puerto Rico aggravated by the slumping economy. For the first half of 2009, commercial and construction loan originations increased by $212.6 million as compared to the first half of 2008, mainly associated with the $500 million facility extended to COFINA which helped the government of Puerto Rico implement its economic stimulus plan. The loan was paid off on June 18, 2009. This was partially offset by lower commercial loan and floor plan originations in Puerto Rico. Commercial originations include floor plan lending activities, which depend on auto inventory levels financed and their turnover. Floor plan originations amounted to approximately $265.4 million for the first half of 2009 compared to $392.6 million for the first half of 2008, due to a reduced turnover given the current economic environment. Construction loan originations for the quarter and six-month period ended June 30, 2009 amounted to $159.9 million and $257.0 million, respectively, compared to $104.2 million and $246.7 million, respectively, for the comparable periods in 2008. Construction loan originations during 2009 consisted mainly of additional disbursements on existing commitments in Puerto Rico. Refer to Loan Portfolio Commercial and Construction Loans discussion below for additional information on the current environment in Florida and Puerto Rico.

Consumer Loans

Consumer loan originations are principally driven through the Corporation s retail network. For the second quarter and first half of 2009, consumer loan originations decreased by $11.4 million and $24.6 million, respectively, compared to the same periods in 2008, adversely impacted by economic conditions in Puerto Rico and the United States.

Finance Leases

For the second quarter and first half of 2009, finance lease originations were also affected by adverse economic conditions in Puerto Rico. For the second quarter and first half of 2009, finance lease originations, which are mostly composed of loans to

Table of Contents

individuals to finance the acquisition of a motor vehicle, decreased by $8.6 million, or 30%, and by $18.3 million, or 31%, as compared to the same periods in 2008.

Assets

Total assets as of June 30, 2009 amounted to $20.0 billion, an increase of $521.6 million compared to total assets as of December 31, 2008. The increase in total assets was primarily a result of an increase of $665.2 million in investment securities, partially offset by a decrease of $157.9 million in cash and cash equivalent funds used to pay down maturing borrowings. The Corporation increased its investment securities portfolio with the purchase of highly liquid securities, such as U.S. agency MBS and debt securities as well as U.S. Treasury investments. Refer to the Net Interest Income discussion above for additional information about securities acquired during 2009.

Loan Portfolio

The composition of the Corporation s loan portfolio, including loans held for sale, as of the dates indicated is as follows:

(In thousands)	June 30, 2009	December 31, 2008
Residential real estate loans	$ 3,654,435	$ 3,491,728
Commercial loans:		
Construction loans	1,580,207	1,526,995
Commercial real estate loans	1,564,933	1,535,758
Commercial loans	4,002,306	3,857,728
Loans to local financial institutions collaterilized by real estate mortgages	336,300	567,720
Total commercial loans	7,483,746	7,488,201
Finance leases	341,119	363,883
Consumer and other loans	1,656,410	1,744,480
	$ 13,135,710	$ 13,088,292

As of June 30, 2009, the Corporation s total loans increased by $47.4 million, when compared with the balance as of December 31, 2008. The increase in the Corporation s total loans primarily relates to increases in commercial loans driven by internal loan originations, partially offset by repayments and charge-offs of approximately $168.4 million recorded in the first half of 2009, mainly in Florida.

Table of Contents

Of the total gross loan portfolio of $13.1 billion as of June 30, 2009, approximately 81% has regional credit risk concentration in Puerto Rico, 11% in the United States (mainly in the state of Florida) and 8% in the Virgin Islands, as shown in the following table.

As of June 30, 2009	Puerto Rico	Virgin Islands	Florida	Total
	(In thousands)			
Residential real estate loans, including loans held for sale	$ 2,801,139	$ 452,588	$ 400,708	$ 3,654,435
Construction loans (1)	965,944	176,392	437,871	1,580,207
Commercial real estate loans	957,835	77,522	529,576	1,564,933
Commercial loans	3,794,278	175,393	32,635	4,002,306
Loans to local financial institutions collateralized by real estate mortgages	336,300			336,300
Total commercial loans	6,054,357	429,307	1,000,082	7,483,746
Finance leases	341,119			341,119
Consumer loans	1,504,645	112,641	39,124	1,656,410
Total loans, gross	$ 10,701,260	$ 994,536	$ 1,439,914	$ 13,135,710

(1) Construction loans of Florida operations include approximately $153.7 million of condo-conversion loans, net of charge-offs of $44.6 million recorded in the second quarter of 2009.

Residential Real Estate Loans

As of June 30, 2009, the Corporation s residential real estate loan portfolio increased by $162.7 million as compared to the balance as of December 31, 2008. More than 90% 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 full documented loans, and the Corporation is not actively involved in the origination of negative amortization loans or adjustable-rate mortgage loans. The increase was driven by a portfolio acquired during the quarter from R&G, a Puerto Rican financial institution and new loan originations during 2009. The R&G transaction involved the purchase of approximately $205 million of residential mortgage loans that previously served as collateral for a commercial loan extended to R&G. The purchase price of the transaction was retained by the Corporation to fully pay off the loan, thereby

significantly reducing the Corporation s exposure to a single borrower. This acquisition had the effect of improving the Corporation s regulatory capital ratios due to the lower risk-weighting of the assets acquired. Additionally, net interest income improves since the weighted-average effective yield on the mortgage loans acquired approximates 5.38% (including non-performing loans) compared to a yield of approximately 150 basis points over 3-month LIBOR in the commercial loan to R&G. Partially offsetting the increase driven by the aforementioned transaction and loan originations was the securitization of approximately $188 million of FHA/VA mortgage loans into GNMA MBS.
Refer to the Contractual Obligations and Commitments discussion below for additional information about outstanding commitments to sell mortgage loans.

Table of Contents

Commercial and Construction Loans

As of June 30, 2009, the Corporation s commercial and construction loan portfolio decreased by $4.5 million, as compared to the balance as of December 31, 2008, due to the aforementioned unwinding transaction with R&G, principal repayments and net charge-offs in 2009, partially offset by loan originations. The Corporation has been able to obtain new originations from corporate customers as well as commercial real estate and construction loans. A substantial portion of this portfolio is collateralized by real estate. The Corporation s commercial loans are primarily variable- and adjustable-rate loans.

The Corporation s largest loan concentration to one borrower of $336.3 million as of June 30, 2009 is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual mortgage loans on residential and commercial real estate.

The Corporation s construction lending volume has been stagnant for the last year due to the slowdown in the U.S. housing market and the current economic environment in Puerto Rico. The Corporation has reduced its exposure to condo-conversion loans in its Florida operations and is closely evaluating market conditions and opportunities in Puerto Rico. Current absorption rates in condo-conversion loans in the United States are low and properties collateralizing some of these condo-conversion loans have been formally reverted to rental properties with a future plan for the sale of converted units upon an improvement in the real estate market. As of June 30, 2009, approximately $47.6 million of loans originally disbursed as condo-conversion construction loans have been formally reverted to income-producing commercial loans, while the repayment of the remaining construction condo-conversion loans is coming principally from rental income and other sources. Given more conservative underwriting standards of banks in general and a reduction of market participants in the lending business, the Corporation believes that the rental market will grow.

The Puerto Rico housing market has not seen the dramatic decline in housing prices that is affecting the U.S. mainland; however, there is currently an oversupply of housing units compounded by a lower demand and declining volume of sales of new housing units and diminished consumer purchasing power and confidence. The unemployment rate in Puerto Rico tops 14%.

Table of Contents

The composition of the Corporation s construction loan portfolio as of June 30, 2009 by category and geographic location follows:

As of June 30, 2009	Puerto Rico	Virgin Islands	Florida	Total
		(In thousands)		
Loans for residential housing projects:				
High-rise [(1)]	$ 200,794	$	$ 559	$ 201,353
Mid-rise [(2)]	95,996	4,980	42,959	143,935
Single-family detach	125,298	2,734	38,810	166,842
Total for residential housing projects	422,088	7,714	82,328	512,130
Construction loans to individuals secured by residential properties	12,332	31,201		43,533
Condo-conversion loans	6,973		153,682	160,655
Loans for commercial projects	299,952	101,153	8,459	409,564
Bridge and land loans	201,196	36,482	193,496	431,174
Working capital	28,009	502		28,511
Total before net deferred fees and allowance for loan losses	970,550	177,052	437,965	1,585,567
Net deferred fees	(4,606)	(660)	(94)	(5,360)
Total construction loan portfolio, gross	965,944	176,392	437,871	1,580,207
Allowance for loan losses	(60,383)	(7,831)	(67,065)	(135,279)
Total construction loan portfolio, net	$ 905,561	$ 168,561	$ 370,806	$ 1,444,928

(1) For purposes of the above table, high-rise portfolio is composed of buildings with more than 7 stories, mainly composed of two projects that represent approximately 74% of the Corporation s

total outstanding high-rise residential construction loan portfolio in Puerto Rico.

(2) 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 six-month period ended June 30, 2009:

		(Dollars in thousands)
Total undisbursed funds under existing commitments	$	401,633
Construction loans in non-accrual status	$	506,642
Net charge offs Construction loans[1]	$	91,370
Allowance for loan losses Construction loans	$	135,279
Non-performing construction loans to total construction loans		32.06%
Allowance for loan losses construction loans to total construction loans		8.56%
Net charge-offs (annualized) to total average construction loans [1]		11.52%

(1) Includes charge-offs of $64.9 million related to construction loans in Florida and $26.5 million related to construction loans in Puerto Rico.

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	$ 99,114
$300k - $600k	185,149
Over $600k	137,825
	$ 422,088

For the majority of the construction loans for residential housing projects in Florida, the estimated selling price of the units is under $300,000.

Consumer Loans

As of June 30, 2009, the Corporation s consumer loan portfolio decreased by $88.1 million, as compared to the portfolio balance as of December 31, 2008. This is mainly the result of repayments and charge-offs that on a combined basis more than offset the volume of loan originations during the first half of 2009. Nevertheless, the Corporation experienced a decrease in net charge-offs for consumer loans that amounted to $26.4 million for the first half of 2009, as compared to $27.3 million for the same period a year ago. The decrease in net charge offs as compared to 2008 is attributable to improvement in the credit quality of this portfolio and changes in underwriting standards implemented in late 2005, which has resulted in new originations under these revised standards, to replace maturing consumer loans with an average lives of approximately four years.

Finance Leases

As of June 30, 2009, finance leases, which are mostly composed of loans to individuals to finance the acquisition of a motor vehicle, decreased by $22.8 million as compared to the portfolio balance as of December 31, 2008, as repayments and charge-offs exceeded the volume of loan originations during the first half of 2009. These leases typically have five-year terms and are collateralized by a security interest in the underlying assets.

Investment Activities

As part of its strategy to diversify its revenue sources and maximize its net interest income, First BanCorp maintains an investment portfolio that is classified as available-for-sale or held-to-maturity. The Corporation s investment portfolio as of June 30, 2009 amounted to $6.4 billion, an increase of $659.0 million when compared with the investment portfolio of $5.7 billion as of December 31, 2008. The increase in investment securities resulted mainly from purchases of approximately $2.8 billion in investment securities that helped to offset lower loan yields and overall lower investment yields due to the call of approximately $937 million of U.S. agency debentures in 2009 and the acceleration of MBS prepayments. Purchases of investment securities during 2009 mainly consist of U.S. agency callable debentures having contractual maturities ranging from two to three years (approximately $1.0 billion at a weighted-average yield of 2.13%), 7-10 Year U.S. Treasury Notes (approximately $96 million at a weighted-average yield of 3.54%), 15-Year U.S. agency MBS (approximately $1.3 billion at a weighted-average yield of 3.85%) and floating collateralized mortgage obligations issued by GNMA, FNMA and FHLMC (approximately $184 million). These purchases were financed with very low cost sources of funding, thus protecting the Corporation s interest margins. There were sales of approximately $660 million in MBS (mainly 30-Year U.S. agency MBS with a weighted-average coupon of 5.66%) during the first half of 2009. Also, during 2009, the Corporation began and completed the securitization of approximately $188 million of FHA/VA mortgage loans into GNMA MBS, of which approximately $25 million were sold before the end of the first half of 2009 with the remaining portion retained as part of the investment portfolio.

Over 95% of the Corporation s available-for-sale and held to maturity securities portfolio is invested in U.S. Government and Agency debentures, fixed-rate

U.S. government sponsored-agency MBS (mainly FNMA and FHLMC fixed-rate securities) or U.S. Treasury securities. The Corporation s investment in equity securities is minimal, and it relates to other financial institutions in Puerto Rico.

The following table presents the carrying value of investments at the indicated dates:

(In thousands)	As of June 30, 2009	As of December 31, 2008
Money market investments	$ 69,825	$ 76,003
Investment securities held to maturity, at amortized cost:		
U.S. Government and agencies obligations	16,735	953,516
Puerto Rico Government obligations	23,309	23,069
Mortgage-backed securities	644,887	728,079
Corporate bonds	2,000	2,000
	686,931	1,706,664
Investment securities available for sale, at fair value:		
U.S. Government and agencies obligations	1,240,395	
Puerto Rico Government obligations	137,035	137,133
Mortgage-backed securities	4,150,023	3,722,992
Corporate bonds		1,548
Equity securities	528	669
	5,527,981	3,862,342
Other equity securities, including $81.9 million and $62.6 million of FHLB stock as of June 30, 2009 and December 31, 2008, respectively	83,430	64,145
Total investments	$ 6,368,167	$ 5,709,154

Mortgage-backed securities at the indicated dates consist of:

(In thousands)	As of June 30, 2009	As of December 31, 2008
Held-to-maturity		
FHLMC certificates	$ 6,713	$ 8,338
FNMA certificates	638,174	719,741
	644,887	728,079

Available-for-sale		
FHLMC certificates	1,760,713	1,892,358
GNMA certificates	336,246	342,674
FNMA certificates	1,784,489	1,373,977
Collateralized Mortgage Obligations issued or guaranteed by FHLMC and GNMA	172,007	
Other mortgage pass-through certificates	96,568	113,983
	4,150,023	3,722,992
Total mortgage-backed securities	$ 4,794,910	$ 4,451,071

82

Table of Contents

The carrying values of investment securities classified as available-for-sale and held-to-maturity as of June 30, 2009 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:

(Dollars in thousands)	**Carrying Amount**	**Weighted Average Yield %**
U.S. Government and agencies obligations		
Due within one year	$ 8,500	1.07
Due after one year through five years	1,143,685	2.12
Due after five years through ten years	96,710	3.54
Due after ten years	8,235	6.13
	1,257,130	2.25
Puerto Rico Government obligations		
Due within one year	4,293	6.14
Due after one year through five years	110,531	5.41
Due after five years through ten years	24,852	5.84
Due after ten years	20,668	5.36
	160,344	5.49
Corporate bonds		
Due after five years through ten years		
Due after ten years	2,000	5.80
Total	1,419,474	2.62
Mortgage-backed securities	4,794,910	4.68
Equity securities	528	3.65
Total investment securities available for sale and held to maturity	$ 6,214,912	4.20

Net interest income of future periods may be affected by the acceleration in prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on securities purchased at a premium, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration in the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. Also, net interest income in future periods might be affected by the Corporation s investment in callable securities. Approximately $937 million of U.S. Agency debentures with an average yield of 5.77% were called during 2009. As of June 30, 2009, the Corporation has approximately $1.2 billion in U.S. agency debentures with embedded calls and with an average yield of 2.20% (mainly securities with contractual maturities of 2-3 years acquired in 2009). Lower reinvestment rates and a time lag between calls, prepayments and/or the maturity of investments and actual reinvestment of proceeds into new investments might affect net interest income in the future. These risks are directly linked to future period market interest rate fluctuations.

Refer to the Risk Management section discussion below for further analysis of the effects of changing interest rates on the Corporation s net interest income and for 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.

Table of Contents

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 eight 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, and (8) contingency risk. First BanCorp has adopted policies and procedures designed to identify and manage risks to which the Corporation is exposed, specifically those relating to liquidity risk, interest rate risk, credit risk, and operational risk.

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 2008 Annual Report on Form 10-K.

Liquidity 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 and accommodate fluctuations in asset and liability levels due to changes in the Corporation s 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 nonbanking subsidiaries. The second is the liquidity of the banking subsidiaries. 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 Operating Officer, the Chief Risk Officer, the Wholesale Banking Executive, the Risk Manager of the Treasury and Investments Division, the Asset/Liability Manager and the Treasurer. The Treasury and Investments Division is responsible for planning and executing the

Table of Contents

Corporation s funding activities and strategy; monitors liquidity availability on a daily basis and reviews 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.

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 customer-based funding, maintaining direct relationships with wholesale market funding providers, and maintaining the ability to liquidate certain assets when, and if, requirements warrant.

The Corporation develops and maintains contingency funding plans for both the parent company and bank liquidity positions. 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 funding 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. In 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 its current funding position, thereby ensuring the ability to honor its commitments, and establishing liquidity triggers monitored by the MIALCO in order to maintain the ordinary funding of the banking business. Three different scenarios are defined in the Contingency Funding Plan: local market event, credit rating downgrade, and a concentration event. They are reviewed and approved annually by the Board of Directors Asset and Liability Committee.

The Corporation has maintained a basic surplus (cash, short-term assets minus short-term liabilities, and secured lines of credit) in excess of a self-imposed minimum limit of 5% of total assets. As of June 30, 2009, the estimated basic surplus ratio of approximately 8.7% included unpledged assets, FHLB lines of credit, collateral pledged at the FED Discount Window Program, and cash. Unpledged liquid securities as of June 30, 2009 mainly consisted of fixed-rate MBS and U.S. agency debentures totaling approximately $711 million, which can be sold under agreements to repurchase. 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 surplus computation. The Corporation has taken direct actions to keep sound liquidity levels and to safeguard its access to credit. Such initiatives include, among other things, the posting of additional collateral, thereby increasing its borrowing capacity with the FHLB and the FED through the Discount Window Program. The Corporation will continue to monitor the different alternatives available under programs currently in place by the FED and the FDIC.

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, securities sold under agreements to repurchase, and lines of credit with the FHLB, the FED Discount Window Program, and other unsecured lines established with financial institutions. The Credit 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. Commercial paper has also in the past provided additional 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.

Recent initiatives by the FED to ease the credit crisis have included, among other things, cuts to the discount rate, the availability of the Term Auction Facility (TAF) to provide short-term loans to banks and expanding the qualifying collateral it will lend against, to include commercial paper. The FDIC also raised the cap on deposit insurance coverage from $100,000 to $250,000 until December 31, 2013. These actions made the federal government a viable source of funding in the current environment.

The Corporation s principal sources of funding are:

Brokered CDs A large portion of the Corporation s funding is retail brokered CDs issued by the Bank subsidiary, FirstBank Puerto Rico. Total brokered CDs decreased from $8.4 billion at year end 2008 to $7.2 billion as of June 30, 2009. The Corporation has been refinancing brokered CDs that matured or were called during 2009 with alternate sources of funding at a lower cost. Approximately $4.5 billion of brokered CDs matured or were called during the first quarter of 2009, of which approximately $1.1 billion were replaced with advances from the FHLB and from the FED as well as short-term repurchase agreements to decrease interest expense and improve the matching of rate repricing of current investment and loan portfolios. All of the $1.1 billion of swapped-to-floating brokered CDs outstanding at the beginning of the year were called in 2009.

In the event that the Corporation s Bank subsidiary falls below the ratios of a well-capitalized institution, it faces the risk of not being able to replace funding through this source. The Bank currently complies and exceeds the minimum requirements of ratios for a well-capitalized institution and does not foresee falling below required levels to issue brokered deposits. The average remaining term to maturity of the retail brokered CDs outstanding as of June 30, 2009 is approximately 0.7 years.

The use of brokered CDs has been 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 the Corporation has been able to obtain substantial amounts of funding in short periods of time. This strategy enhances the Corporation s liquidity position, since the brokered

Table of Contents

CDs are insured by the FDIC up to regulatory limits and can be obtained faster compared to regular retail deposits. Demand for brokered CDs has recently increased as a result of the move by investors from riskier investments, such as equities, to federally guaranteed instruments such as brokered CDs and the recent increase in FDIC deposit insurance from $100,000 to $250,000. For the six-month period ended June 30, 2009, the Corporation issued $3.3 billion in brokered CDs at an average rate of 1.01% (including the rollover of short-term brokered CDs and replacement of brokered CDs called) with a weighted-average maturity of 6 months.

The following table presents a maturity summary of brokered and retail CDs with denominations of $100,000 or higher as of June 30, 2009.

	Total
	(In thousands)
Three months or less	$ 2,412,131
Over three months to six months	2,391,123
Over six months to one year	1,933,444
Over one year	1,552,489
Total	$ 8,289,187

Certificates of deposit in denominations of $100,000 or higher include brokered CDs of $7.2 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 also include $17.5 million of deposits through the Certificate of Deposit Account Registry Service (CDARS). In an effort to meet customer needs and provide its customers with the best products and services available, the Corporation s bank subsidiary, FirstBank Puerto Rico, has joined a program that gives depositors the opportunity to insure their money beyond the standard FDIC coverage. CDARS can offer customers access to multi-million dollar FDIC insurance coverage of up to $50 million when they enter into the CDARS Deposit Placement Agreement, while earning attractive returns on their deposits.

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, increased by $171.7 million from the balance as of December 31, 2008, reflecting increases in core-deposit products such as savings and interest-bearing checking accounts. In Puerto Rico, the Corporation s primary market, total deposits, excluding brokered CDs, increased by $282.2 million from the balance as of December 31, 2008, reflecting successful marketing campaigns and cross-selling initiatives. Refer to Note 10 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 six-month periods ended June 30, 2009 and 2008.

Table of Contents

Securities sold under agreements to repurchase - The growth of the Corporation s investment portfolio is substantially funded with repurchase agreements. Securities sold under repurchase agreements were $4.1 billion at June 30, 2009, compared with $3.4 billion at December 31, 2008. The Corporation increased its short-term borrowing to manage its interest rate risk by matching the shortening in the average life of the investment portfolio. Also, one of the Corporation s strategies is 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 cost at reasonable levels. Of the total of $4.1 billion repurchase agreements outstanding as of June 30, 2009, approximately $2.4 billion consist of structured repos and $600 million of long-term repos. The access to this type of funding has been affected by the liquidity turmoil in the financial markets witnessed in the second half of 2008 and the first half of 2009. Certain counterparties have not been willing to enter into additional repurchase agreements and the capacity to extend the term of maturing repurchase agreements has also been reduced. Refer to Note 12 in the accompanying notes to the unaudited interim consolidated financial statements for further details about repurchase agreements outstanding by counterparty and maturities.

Under the Corporation s repurchase agreements, as is the case with derivative contracts, the Corporation is required to deposit cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines because of changes in interest rates, a liquidity crisis or any other factor, the Corporation will be 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 did not experience significant margin calls from counterparties recently arising from writedowns in valuations with only $0.9 million of cash deposited in connection with collateralized repurchase agreements and $1.9 million in connection with collateralized interest rate swap agreements.

Advances from the FHLB The Corporation s Bank subsidiary 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 minimum qualifying mortgages as collateral for advances taken. As of June 30, 2009 and December 31, 2008, the outstanding balance of FHLB advances was $1.3 billion and $1.1 billion, respectively. Approximately $740.4 million of outstanding advances from the FHLB has maturities over one year. As part of its precautionary initiatives to safeguard access to credit and the low level of interest rates, the Corporation increased its capacity under FHLB credit facilities by posting additional collateral and, as of June 30, 2009, it had $402 million available for additional borrowings.

FED Discount window FED initiatives to ease the credit crisis have included cuts to the discount rate, which was lowered from 4.75% to 0.50% through eight separate actions since December 2007, and adjustments to previous practices to facilitate financing for longer periods. This makes the FED Discount Window a viable source of funding given current market conditions. In the first quarter of 2009, the Corporation received approval to participate in the BIC Program of the FED and, as of June 30, 2009, approximately

$514 million of available credit under the BIC program, including auto loans and commercial loans. As of June 30, 2009, the Corporation had $135 million outstanding in short-term borrowings from the FED Discount Window.

Credit Lines - The Corporation maintains unsecured and un-committed lines of credit with other banks. As of June 30, 2009, the Corporation s total unused lines of credit with other banks amounted to $100 million. The Corporation has not used these 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 has 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 and if available will be on comparable terms. The Corporation continues to evaluate its financing options, including available options resulting from recent federal government initiatives to deal with the crisis in the financial markets.

The Corporation s principal uses of funds are the origination of loans and the repayment of maturing deposits and borrowings. Over the last four years, the Corporation has committed substantial resources to its mortgage banking subsidiary, FirstMortgage Inc. As a result, residential real estate loans as a percentage of total loans receivable have increased over time from 14% at December 31, 2004 to 28% at June 30, 2009. 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. Recent disruptions in the credit markets and a reduced investors demand for mortgage debt have adversely affected the liquidity of the secondary mortgage markets. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid in large part because of the sale or guarantee programs of the FHA, VA, HUD, FNMA and FHLMC. The Corporation obtained from GNMA Commitment Authority to issue GNMA mortgage-backed securities and under this program, the Corporation completed the securitization of approximately $188 million of FHA/VA mortgage loans into GNMA MBS, of which approximately $25 million were sold before the end of the first half of 2009. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

Table of Contents

Credit Ratings

The Corporation s credit as long-term issuer is currently rated BB+ by Standard & Poor s (S&P) and BB by Fitch Ratings Limited (Fitch); both with negative outlook.

At the FirstBank subsidiary level, long-term senior debt is currently rated Ba1 by Moody s Investor Service (Moodys) and BB+ by S&P, one notch under their definition of investment grade. Fitch has rated the Bank s long-term senior debt BB, two notches under investment grade. The outlook on the Bank s credit ratings from the three rating agencies is negative.

The Corporation does not have any outstanding debt or derivative agreements that would be affected by a credit downgrade. The Corporation s liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. Any future downgrades in credit ratings can hinder the Corporation s access to external funding and/or cause external funding to be more expensive, which could in turn adversely affect the results of operations. Also, any change in credit ratings may affect the fair value of certain liabilities and unsecured derivatives that consider the Corporation s own credit risk as part of the valuation.

Cash Flows

Cash and cash equivalents were $247.8 million and $271.9 million at June 30, 2009 and 2008, respectively. These balances decreased by $157.9 million and by $107.1 million from December 31, 2008 and 2007, respectively. The following discussion highlights the major activities and transactions that affected the Corporation s cash flows during the first half of 2009 and 2008.

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 half of 2009, net cash provided by operating activities was $127.2 million. Net cash generated from operating activities was higher than net loss reported largely as a result of adjustments for operating items such as the provision for loan and lease losses.

For the first half of 2008, net cash provided by operating activities was $67.4 million, which was slightly higher than net income, mainly as a result of adjustments for operating items such as the provision for loan and lease losses, depreciation expenses and amortization of placement fees, partially offset by adjustments to net income from gain on sale of investments (including the gain on the mandatory redemption of part of the

Corporation s investment in VISA in March 2008), deferred income tax benefits and a decrease in accrued interest payable.

Cash Flows from Investing Activities

The Corporation s investing activities primarily include originating loans to be held to maturity and its available-for-sale and held-to-maturity investment portfolios. For the six-month period ended June 30, 2009, net cash of $738.7 million was used in investing activities, primarily for loan origination disbursements and purchases of available-for-sale investment securities to mitigate in part the impact of investments securities, mainly U.S. Agency debentures, called by counterparties prior to maturity and MBS prepayments. Partially offsetting these uses of cash were proceeds from sales and maturities of available-for-sale securities as well as proceeds from held-to-maturity securities called during 2009, and proceeds from loans and from MBS repayments.

For the first half of 2008, net cash used in investing activities was $1.8 billion, primarily due to loan origination disbursements and purchases of MBS that provided an attractive yield given the interest rate scenario during the early part of 2008.

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. In addition, the Corporation paid monthly dividends on its preferred stock and quarterly dividends on its common stock until it announced the suspension of dividends beginning in August 2009. In the first half of 2009, net cash provided by financing activities was $453.6 million due to the investment of $400 million by the U.S. Treasury in preferred stock of the Corporation through the U.S. Treasury TARP Capital Purchase Program and due to the use of the FED Discount Window Program, advances from the FHLB and short-term repurchase agreements to refinance brokered CDs at a lower cost and finance the Corporation s investing activities. Partially offsetting these cash proceeds was the payment of cash dividends and pay down of maturing borrowings, in particular brokered CDs.

In the first half of 2008, net cash provided by financing activities was $1.7 billion due to an increase in the Corporation s deposit base and a net increase in securities sold under repurchase agreements used to fund purchases of investment securities in 2008. Partially offsetting these cash inflows were funds used to pay dividends.

Table of Contents

Capital

The Corporation s stockholders equity amounted to $1.8 billion as of June 30, 2009, an increase of $292.6 million compared to the balance as of December 31, 2008, driven by the $400 million investment by the United States Department of the Treasury (the U.S. Treasury) in preferred stock of the Corporation through the U.S. Treasury Troubled Asset Relief Program (TARP) Capital Purchase Program. Partially offsetting this increase was the net loss of $56.8 million incurred in the first half of 2009, dividends amounting to $39.7 million for the first half of 2009 ($13.0 million, or $0.14 per common share, and $26.7 million in preferred stock), and a decrease of $11.0 million in accumulated other comprehensive income. The Return on Average Common Equity ratio decreased from 10.46% for the first half of 2008 to (16.99%) for the first half of 2009, mainly attributable to the net loss incurred in the first half of 2009 and increase in preferred dividends. Net loss attributable to common stockholders was affected by $9.2 million in dividends (including $2.6 million cumulative dividends not declared as of June 30, 2009) and $2.0 million non-cash discount amortization on the Corporation s Series F Preferred Stock issued under the U.S. Treasury s TARP Capital Purchase Program.

On July 30, 2009, the Corporation announced the suspension of dividends for common and all its outstanding series of preferred stock. This suspension is effective with the dividends for the month of August 2009 on the Corporation s five outstanding series of non-cumulative preferred stock and the dividends for the Corporation s outstanding Series F Cumulative Preferred Stock and the Corporation s common stock. The Corporation took this prudent action to preserve capital as the duration and depth of recessionary economic conditions is uncertain and consistent with federal regulatory guidance.

The Corporation s tangible common equity ratio stands at 4.35% as of June 30, 2009, compared to 4.87% as of December 31, 2008, and the Tier 1 common equity to risk-weighted assets ratio as of June 30, 2009 was 4.73% compared to 5.92% as of December 31, 2008.

The tangible common equity ratio and the tangible book value per common share are non-GAAP measures generally used by financial analysts and investment bankers to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill and core deposit intangibles. Tangible Assets are total assets less goodwill and core deposit intangibles. Management and many stock analysts use the tangible common equity ratio and the 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 accounting method accounting for mergers and acquisitions. Neither tangible common equity nor tangible assets or 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

Table of Contents

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. The following table is a reconciliation of the Corporation s tangible common equity and tangible assets for the periods ended June 30, 2009 and December 31, 2008, respectively.

(In thousands)	**June 30, 2009**	**December 31, 2008**
Total equity per consolidated financial statements	$ 1,840,686	$ 1,548,117
Preferred equity	(926,259)	(550,100)
Goodwill	(28,098)	(28,098)
Core deposit intangible	(18,130)	(23,985)
Tangible common equity	$ 868,199	$ 945,934
Total assets per consolidated financial statements	$ 20,012,887	$ 19,491,268
Goodwill	(28,098)	(28,098)
Core deposit intangible	(18,130)	(23,985)
Tangible assets	$ 19,966,659	$ 19,439,185
Common shares outstanding	92,546	92,546
Tangible common equity ratio	4.35%	4.87%
Tangible book value per common share	$ 9.38	$ 10.22

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 applicable bank regulatory requirements. The Tier 1 common equity ratio is not required by U.S. generally accepted accounting principles, or GAAP, or on a recurring basis by applicable bank regulatory requirements. However, this ratio was used by the Federal Reserve in connection with its stress test administered to the 19 largest U.S. bank holding companies under the Supervisory Capital Assessment Program (SCAP), the results of which were announced on May 7, 2009. Although we understand that the Federal Reserve does not intend to prospectively require calculation of the Tier 1 common equity ratio, due to the recent timing of the SCAP, management is currently monitoring this ratio, along with the other ratios set forth in the table above, in evaluating the Corporation s capital levels and believes that, at this time, the ratio may be of interest to investors.

Table of Contents

The following table reconciles stockholders equity (GAAP) to Tier 1 common equity:

(In thousands)	June 30, 2009	December 31, 2008
Total equity per consolidated financial statements	$ 1,840,686	$ 1,548,117
Qualifying preferred stock	(926,259)	(550,100)
Unrealized gain on available-for-sale securities (1)	(46,382)	(57,389)
Disallowed deferred tax asset (2)	(172,187)	(69,810)
Goodwill	(28,098)	(28,098)
Core deposit intangible	(18,130)	(23,985)
Cumulative change loss (gain) in fair value of liabilities elected to be measured at fair value under SFAS 159, net of tax	2,604	(3,473)
Other disallowed assets	(347)	(508)
Tier 1 common equity	$ 651,887	$ 814,754
Total risk-weighted assets	$ 13,785,821	$ 13,762,378
Tier 1 common equity to risk-weighted assets ratio	4.73%	5.92%

(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.

(2) Approximately $49 million of the Corporation s $218 million of net deferred tax assets at June 30, 2009 (December 31, 2008 $58 million of $128 million of net deferred tax assets) were included without limitation in regulatory capital pursuant to the risk-based capital guidelines, while approximately $172 million of such assets at June 30, 2009 (December 31, 2008 - $70 million) exceeded the limitation imposed by these guidelines and, as disallowed deferred tax assets, were deducted in arriving at Tier 1 capital. According to regulatory capital guidelines, the deferred tax assets that are dependent upon future taxable income are limited for inclusion in Tier 1 capital to the lesser of: (i) the amount of such deferred tax asset that the entity expects to realize

within one year of the calendar quarter end-date, based on its projected future taxable income for that year or (ii) 10% of the amount of the entity s Tier 1 capital. Approximately $3 million of the Corporation s other net deferred tax liability at June 30, 2009 (December 31, 2008 $0) represented primarily the deferred tax effects of unrealized gains and losses on available-for-sale debt securities, which are permitted to be excluded prior to deriving the amount of net deferred tax assets subject to limitation under the guidelines.

As of June 30, 2009, First BanCorp, FirstBank Puerto Rico and FirstBank Florida were in compliance with regulatory capital requirements that were applicable to them as a financial holding company, a state non-member bank and a thrift, respectively (i.e., total capital and Tier 1 capital to risk-weighted assets of at least 8% and 4%, respectively, and Tier 1 capital to average assets of at least 4%). Set forth below are First BanCorp s, FirstBank Puerto Rico s and FirstBank Florida s regulatory capital ratios as of June 30, 2009 and December 31, 2008, based on existing Federal Reserve, Federal Deposit Insurance Corporation and the Office of Thrift Supervision guidelines. Refer to Note 23 of the accompanying unaudited consolidated financial statements for information about the merger of FirstBank Florida into FirstBank Puerto Rico, the Corporation s main banking subsidiary.

Table of Contents

			Banking Subsidiaries	
	First Ban Corp	FirstBank	FirstBank Florida	To be well capitalized
As of June 30, 2009				
Total capital (Total capital to risk-weighted assets)	14.35%	13.35%	19.92%	10.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	13.08%	12.08%	18.77%	6.00%
Leverage ratio [(1)]	9.12%	8.42%	13.65%	5.00%
As of December 31, 2008				
Total capital (Total capital to risk-weighted assets)	12.80%	12.23%	13.53%	10.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	11.55%	10.98%	12.43%	6.00%
Leverage ratio [(1)]	8.30%	7.90%	8.78%	5.00%

(1) Tier 1 capital to average assets in the case of First BanCorp and FirstBank and Tier 1 Capital to adjusted total assets in the case of FirstBank Florida.

The increase in regulatory capital ratios is mainly related to the $400 million investment by the U.S. Treasury in preferred stock of the Corporation through the U.S. Treasury TARP Capital Purchase Program. Refer to Note 16 of the accompanying unaudited consolidated financial statements and Item 5 of the Corporation s Annual Report on Form 10-K for the year ended December 31, 2008 for additional information regarding this issuance. The funds were used in part to strengthen the Corporation s lending programs and ability to support growth strategies that are centered on customers needs, including programs to preserve home ownership. Together with private and public sector initiatives, the Corporation looks to support the local economy and the communities it serves during the current economic environment.

The Corporation is well-capitalized, having sound margins over minimum well-capitalized regulatory requirements. As of June 30, 2009, the total regulatory capital ratio is 14.4% and the Tier 1 capital ratio is 13.1%. This translates to approximately $600 million and $975 million of total capital and Tier 1 capital, respectively, in excess of the total capital and Tier 1 capital well capitalized requirements of 10% and 6%, respectively.

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 than 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 June 30, 2009, commitments to extend credit and commercial

95

and financial standby letters of credit amounted to approximately $1.4 billion and $101.6 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 s mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers.

Contractual Obligations and Commitments

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:

	Contractual Obligations and Commitments As of June 30, 2009				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
	(In thousands)				
Contractual obligations:					
Certificates of deposit [1]	$ 8,955,394	$ 7,239,183	$ 1,328,674	$ 381,345	$ 6,192
Loans payable	135,000	135,000			
Federal funds purchased and securities sold under agreements to repurchase	4,130,092	1,730,092	1,000,000	900,000	500,000
Advances from FHLB	1,325,440	585,000	507,000	233,440	
Notes payable	24,388		12,823		11,565
Other borrowings	231,959				231,959
Total contractual obligations	$ 14,802,273	$ 9,689,275	$ 2,848,497	$ 1,514,785	$ 749,716
Commitments to sell mortgage loans	$ 183,456	$ 183,456			
Stanby letters of credit	$ 101,635	$ 101,635			
Commitments to extend credit:					
Lines of credit	$ 944,453	$ 944,453			
Letters of credit	42,239	42,239			
Commitments to originate loans	405,773	405,773			
Total commercial commitments	$ 1,392,465	$ 1,392,465			

(1) Includes $7.2 billion of brokered CDs

generally sold by third-party intermediaries in denominations of $100,000 or less, within FDIC insurance limits and $17.5 million in CDARS.

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 commitments 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. The funding needs patterns of the customers have not significantly changed as a result of the latest market disruptions. In the case of credit cards and personal lines of credit, the Corporation can at any time and without cause cancel the unused credit facility. In the ordinary course of business, the Corporation enters into operating leases and other commercial commitments. There have been no significant changes in such contractual obligations since December 31, 2008.

Lehman Brothers Special Financing, Inc. (Lehman) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which

constitutes an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement due as of June 30, 2009, under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately $1.4 million. This exposure was reserved in the third quarter of 2008. The Corporation had pledged collateral of $63.6 million with Lehman to guarantee its performance under the swap agreements in the event payment thereunder was required. The book value of pledged securities with Lehman as of June 30, 2009 amounted to approximately $64.5 million. The position of the Corporation with respect to the recovery of the collateral, after discussion with its outside legal counsel, is that at all times title to the collateral has been vested in the Corporation and that, therefore, this collateral should not, for any purpose, be considered property of the bankruptcy estate available for distribution among Lehman s creditors. On January 30, 2009, the Corporation filed a customer claim with the trustee and at this time the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value. As additional relevant facts become available in future periods, a need to recognize a partial or full reserve of this claim may arise. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation decided to classify such investments as non-performing during the second quarter of 2009.

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 in the profitability under varying interest rate environments. The MIALCO oversees interest rate risk and meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, unrealized gains and losses in securities, recent or proposed changes to the investment portfolio, alternative funding sources and their 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 growth strategies and objectives.

The Corporation performs on a quarterly basis 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-year to a five-year time horizon, assuming gradual upward and downward interest rate movements of 200 basis points, achieved 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 growing balance sheet based on recent growth patterns and strategies.

Table of Contents

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing 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, deposits decay and other factors which may be important in projecting the future growth of 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 use many simplifying assumptions that are intended to reflect the general behavior of the Corporation over the period in question. It is highly unlikely that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates.

The following table presents the results of the simulations as of June 30, 2009 and December 31, 2008. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives and SFAS 159 liabilities:

	June 30, 2009 Net Interest Income Risk (Projected for the next 12 months)				**December 31, 2008 Net Interest Income Risk (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	$ (8.0)	(1.53)%	$(10.4)	(1.89)%	$ 6.5	1.39%	$ 6.4	1.29%
- 200 bps ramp	$(27.5)	(5.28)%	$(28.2)	(5.16)%	$(12.8)	(2.77)%	$(15.5)	(3.15)%

During the first 12 months of the income simulation, under a parallel rising rates scenario, net interest income is expected to compress. During the second quarter, the Corporation changed the mix of its funding sources, and increased its short-term borrowing as a measure of interest rate risk management to match the shortening in the average life of the investment portfolio. Brokered CDs with original maturities over 6 months and issued when interest rates were higher, matured or were called during the quarter. Current short-term rates on repurchase agreement, FHLB and FED advances provided a cost effective funding alternative, in conjunction with the participation in the Borrower-In-Custody Program (BIC) of the FED, which allows the pledging of loans as collateral for borrowings at the FED Discount Window. Funds obtained through short-term borrowings, as well as proceeds from higher prepayments speeds on mortgage-backed securities are being reinvested in instruments with shorter durations, such as U.S. agency callable debentures with contractual maturities ranging from two to three years and 15-Years U.S. agency MBS. In addition, approximately $937 million of long-term U.S. Agency debentures were called during the first half of 2009.

The Corporation s loan and investment portfolio is subject to prepayment risk, which results from the ability of a third party to repay their debt obligations prior to maturity. In

a rising rate scenario, the prepayment risk in our U.S. government agency fixed-rate MBS portfolio is expected to decrease substantially.

Taking into consideration the above-described facts for purpose of modeling, the net interest income for the next twelve months in a growing balance sheet scenario, is estimated to decrease by $10.4 million in a parallel upward move of 200 basis points. Assuming parallel shifts in interest rates, the Corporation s net interest income would continue to decrease in rising rates scenarios over a five-year modeling horizon.

In order to comply with First BanCorp risk management policies, we continue modeling the downward parallel rates moves by anchoring the short end of the curve, (falling rates with a flattening curve), even though given the current level of rates as of June 30, 2009 some market interest rate were projected to be zero. Under this scenario, the net interest income for the next twelve months in a growing balance sheet scenario is estimated to decrease by $28.2 million.

The Corporation used the gap analysis tool to evaluate the potential effect of rate shocks on income over the selected time periods. The gap report as of June 30, 2009 showed a positive cumulative gap for 3 month of $0.35 billion and a negative cumulative gap of $2.89 billion for 1 year, compared to positive cumulative gaps of $2.1 billion and $1.4 billion for 3 months and 1 year, respectively, as of December 31, 2008.

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 against rising interest rates. Specifically, the interest rate on certain private label mortgage pass-through securities and certain of the Corporation s commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the pass-through certificate or referenced residential mortgage collateral, less a contractual servicing fee.

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 June 30, 2009, most of the interest rate swaps outstanding are used for protection against rising interest rates. In the past, interest rate swaps volume was much higher since they were used to convert fixed-rate brokered CDs (liabilities), mainly those with long-term maturities, to a variable rate

and mitigate the interest rate risk inherent in variable rate loans. However, most of these interest rate swaps were called during 2009, in the face of lower interest rate levels, and as a consequence the Corporation exercised its call option on the swapped-to-floating brokered CDs.

Structured repurchase agreements The Corporation uses structured repurchase agreements, with embedded call options, to reduce the Corporation s exposure to interest rate risk by lengthening the contractual maturities of its liabilities, while keeping funding costs low. Another type of structured repurchase agreement includes repurchased agreements with embedded cap corridors; these instruments also provide protection for a rising rate scenario.

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, refer to Note 8 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:

(In thousands)	**Six-month period ended June 30, 2009**
Fair value of contracts outstanding at the beginning of the period	$ (495)
Fair value of new contracts at inception	(35)
Contracts terminated or called during the period	(5,198)
Changes in fair value during the period	3,957
Fair value of contracts outstanding as of June 30, 2009	$ (1,771)

Source of Fair Value

	Payments Due by Period				
(In thousands)	**Maturity Less Than One Year**	**Maturity 1-3 Years**	**Maturity 3-5 Years**	**Maturity In Excess of 5 Years**	**Total Fair Value**
As of June 30, 2009					
Pricing from observable market inputs	$ (1,049)	$ 36	$ (581)	$ (3,691)	$ (5,285)
Pricing that consider unobservable market inputs				3,514	3,514
	$ (1,049)	$ 36	$ (581)	$ (177)	$ (1,771)

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 as well as the level of interest rates.

As of June 30, 2009, all of the derivative instruments held by the Corporation were considered economic undesignated hedges.

Table of Contents

During the first half of 2009, all of the $1.1 billion of interest rate swaps that economically hedge brokered CDs were called by the counterparties, mainly due to lower levels of 3-month LIBOR. Following the cancellation of the interest rate swaps, the Corporation exercised its call option on the approximately $1.1 billion swapped-to- floating brokered CDs. The Corporation recorded a net loss of $3.5 million as a result of these transactions resulting from the reversal of the cumulative mark-to-market valuation of the swaps and the brokered CDs called.

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. Currently the Corporation is mostly engaged in derivative instruments with counterparties with a credit rating of single A or better. 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.

Set forth below is a detailed analysis of the Corporation s credit exposure by counterparty with respect to derivative instruments outstanding as of June 30, 2009 and December 31, 2008.

(In thousands)			As of June 30, 2009			
Counterparty	**Rating** [1]	**Notional**	**Total Exposure at Fair Value** [2]	**Negative Fair Values**	**Total Fair Values**	**Accrued Interest Receivable (Payable)**
Interest rate swaps with rated counterparties:						
JP Morgan	A+	$ 158,305	$ 304	$ (4,353)	$ (4,049)	$
Credit Suisse First Boston	A+	54,579	7	(1,355)	(1,348)	
Goldman Sachs	A	6,515	241		241	
Mortgan Stanley	A	109,928	506		506	
		329,327	1,058	(5,708)	(4,650)	
Other derivatives [3]		391,349	3,840	(961)	2,879	(257)
		$ 720,676	$ 4,898	$ (6,669)	$ (1,771)	$ (257)

(1) Based on the S&P and Fitch Long Term Issuer Credit Ratings.

(2) For each counterparty, this amount includes

derivatives with positive fair value excluding the related accrued interest receivable / payable.

(3) Credit exposure with several Puerto Rico counteraparties for wich a credit rating in not readily available. Approximately $3.5 million of the credit exposure with local companies relates to caps referenced to mortgages bought from R&G Premier Bank.

(In thousands)			As of December 31, 2008			
Counterparty	Rating [1]	Notional	Total Exposure at Fair Value [2]	Negative Fair Values	Total Fair Values	Accrued Interest Receivable (Payable)
Interest rate swaps with rated counterparties:						
Wachovia	AA-	$ 16,570	$ 41	$	$ 41	$ 108
Merrill Lynch	A	230,190	1,366		1,366	(106)
UBS Financial Services, Inc.	A+	14,384	88		88	179
JP Morgan	A+	531,886	2,319	(5,726)	(3,407)	1,094
Credit Suisse First Boston	A+	151,884	178	(1,461)	(1,283)	512
Citigroup	A+	295,130	1,516	(1)	1,515	2,299
Goldman Sachs	A	16,165	597		597	158
Mortgan Stanley	A	107,450	735		735	59
		1,363,659	6,840	(7,188)	(348)	4,303
Other derivatives [3]		332,634	1,170	(1,317)	(147)	(203)
		$ 1,696,293	$ 8,010	$ (8,505)	$ (495)	$ 4,100

(1) Based on the S&P and Fitch Long Term Issuer Credit Ratings.

(2) For each counterparty, this amount includes derivatives with positive fair value excluding the related accrued interest receivable / payable.

(3) Credit exposure with several Puerto Rico

counterparties for wich a credit rating in not readily available. Approximately $0.8 million of the credit exposure with local companies relates to caps referenced to mortgages bought from R&G Premier Bank.

A Hull-White Interest Rate Tree approach is used to value the option components of derivative instruments. The discounting of the cash flows is performed using US dollar LIBOR-based discount rates or yield curves that account for the industry sector and the credit rating of the counterparty and/or 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 resulted in an unrealized loss of approximately $0.8 million as of June 30, 2009, of which an unrealized loss of $2.7 million was recorded in the first half of 2009 and an unrealized gain of $0.1 million in the first half of 2008. The Corporation compares the valuations obtained with valuations received from counterparties, as an internal control procedure.

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 the Interest Rate Risk Management section above. The Corporation manages its credit risk through credit policy, underwriting, and quality control procedures and an established delinquency committee. The Corporation also employs proactive

collection and loss mitigation efforts. Furthermore, there are Loan Workout functions responsible for avoiding defaults and minimizing losses upon default of commercial and construction loans. The group 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 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 backed by the full faith and credit of the U.S. government and is deemed to be of the highest credit quality.

Management, comprised of the Corporation s Chief 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 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. Management allocates specific portions of the allowance for loan and lease losses to problem loans that are identified through an asset classification analysis. The adequacy of the allowance for loan and lease losses is based upon a number of factors, including loan and lease loss experience, that may not fully represent current conditions inherent in the portfolio. For example, factors affecting the Puerto Rico, Florida (USA), US Virgin Islands or British Virgin Islands economies may contribute to delinquencies and defaults above the Corporation s historical loan and lease losses. The Corporation addresses these risks by actively monitoring the delinquency and default experience and by considering current economic and market conditions and their probable impact on the borrowers. Based on the assessment of current conditions, the Corporation makes appropriate adjustments to the assumptions when necessary to adjust factors to account for present conditions. The Corporation also takes into consideration information about trends on non-accrual loans, delinquencies, changes in underwriting policies, and other risk characteristics relevant to the particular loan category and delinquencies. Although management 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.VI or British VI may contribute to delinquencies and defaults, thus necessitating additional reserves.

The allowance for loan and lease losses is established based on management s evaluation of the probable inherent losses in the portfolio in accordance with SFAS 114 and SFAS 5, Accounting for Contingencies. The allowance for loan and lease losses is comprised of both specific valuation allowances and general valuation allowances.

The Corporation measures impairment individually for those commercial and construction loans with a principal balance of $1 million or more in accordance with the provisions of SFAS 114. A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. A specific reserve is determined for those loans classified as impaired, primarily based on each such loan s collateral value (if the impaired loan is determined to be collateral dependent) or the present value of expected future cash flows discounted at the loan s effective interest rate. When foreclosure is probable, the creditor is required to measure the impairment based on the fair value of the collateral. The fair value of the collateral is generally obtained from appraisals. Updated appraisals are obtained when the Corporation determines that loans are impaired and are updated periodically thereafter. Appraisals are also obtained for certain residential mortgage loans and real estate loans on a spot basis based on specific characteristics such as delinquency levels, age of the appraisal, and loan-to-value ratios. Deficiencies resulting from the excess of the recorded investment in collateral dependent loans over the resulting fair value of the collateral are evaluated to determine whether these require to be charged-off.

For loans individually reviewed and not determined to be impaired and for small, homogeneous loans, including auto loans, consumer loans, finance lease loans, residential mortgage, commercial and construction loans in amounts under $1.0 million, the Corporation maintains general valuation allowances. The consumer loans general reserve is based on factors such as delinquency trends, credit bureau score bands, portfolio type, geographical location, bankruptcy trends, recent market transactions, and other environmental factors such as economic forecasts. The evaluation of residential mortgages is performed at the individual loan level and then aggregated to determine the expected loss ratio. The model is based on risk-adjusted prepayment curves, default curves, and severity curves. The severity is affected by the expected house price scenario based on the most recent house price historical trends. Default curves are used in the model to determine expected delinquency levels. The risk-adjusted timing of liquidation and associated costs are used in the model and are risk-adjusted for the area in which the property is located (Puerto Rico or Virgin Islands). For residential mortgages in Florida, the model is based on aggregate historical loss ratios adjusted by changes in appraisal values, delinquency factors, and other regional environmental factors. For commercial loans, including construction loans, the general reserve is based on historical loss ratios, loan type, risk-rating, geographical location, changes in collateral values for collateral dependent loans and Gross Product (GP) data for each geographical region. The methodology of accounting for all probable losses is made in accordance with the guidance provided by SFAS 5.

As a general procedure, the Credit Risk area requests new collateral appraisals for impaired collateral dependent loans. In addition, on a sample basis, for other non impaired real estate loans in order to determine present market conditions in Puerto Rico, Florida, and the Virgin Islands. To gauge property appreciation or depreciation rates, opinions of value are requested for a sample of delinquent residential real estate loans. The valuation information gathered through these appraisals is considered in the Corporation s allowance model assumptions.

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. 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 real estate market. Recent economic reports related to the real estate market in Puerto Rico indicate that certain pockets of the real estate market are subject to readjustments in value driven by the deteriorated purchasing power of consumers and general economic conditions. The Corporation sets adequate loan-to-value ratios upon original loan approval following the regulatory and credit policy standards. The real estate market for the U.S. Virgin Islands remains fairly stable. In the Florida market, residential real estate is experiencing a very slow turnover.

The following tables set forth an analysis of the activity in the allowance for loan and lease losses during the periods indicated :

	Quarter Ended June 30,		Six-month Period Ended June 30,	
(Dollars in thousands)	**2009**	**2008**	**2009**	**2008**
Allowance for loan and lease losses, beginning of period	$ 302,531	$ 210,495	$ 281,526	$ 190,168
Provision for loan and lease losses	235,152	41,323	294,581	87,116
Loans charged-off:				
Residential real estate	(3,329)	(1,129)	(10,491)	(2,368)
Commercial	(27,994)	(11,350)	(36,103)	(15,768)
Construction	(82,847)	(2,526)	(91,381)	(6,311)
Finance leases	(2,436)	(2,061)	(5,006)	(4,976)
Consumer	(14,769)	(14,536)	(30,854)	(29,565)
Recoveries	1,438	2,056	5,474	3,976
Net charge-offs	(129,937)	(29,546)	(168,361)	(55,012)
Allowance for loan and lease losses, end of period	$ 407,746	$ 222,272	$ 407,746	$ 222,272
Allowance for loan and lease losses to period end total loans receivable	3.11%	1.82%	3.11%	1.82%
Net charge-offs annualized to average loans outstanding during the period	3.85%	0.97%	2.52%	0.91%
Provision for loan and lease losses to net charge-offs during the period	1.81x	1.40x	1.75x	1.58x

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

	As of June 30, 2009		As of December 31, 2008	
(In thousands)	**Amount**	**Percent**	**Amount**	**Percent**
Residential real estate	$ 34,432	28%	$ 15,016	27%
Commercial real estate loans	32,621	12%	17,775	12%
Construction loans	135,279	12%	83,482	12%
Commercial loans (including loans to local financial institutions)	126,746	33%	74,358	33%
Consumer loans (1)	78,668	15%	90,895	16%
	$ 407,746	100%	$ 281,526	100%

(1) Includes lease financing.

The following table sets forth information concerning the composition of the Corporation s allowance for loan and lease losses as of June 30, 2009 and December 31, 2008 by loan category and by whether the allowance and related provisions were calculated individually pursuant the requirements of SFAS 114 or through a general valuation allowance in accordance with the provisions of SFAS 5:

	As of June 30, 2009					
(Dollars in thousands)	**Construction Loans**	**Commercial Loans**	**Comercial Mortgage Loans**	**Residential Mortgage Loans**	**Consumer and Finance Leases**	**Total**
SFAS 114 - Specific Reserves						
Principal balance of loans	$ 552,331	$ 183,343	$ 130,958	$ 68,957	$	$ 935,589
Allowance for loan and lease losses	78,455	22,860	12,640	3,571		117,526
Allowance for loan and lease losses to principal balance	14.20%	12.47%	9.65%	5.18%		12.56%
SFAS 5 - General Allowance						
Principal balance of loans	1,027,876	4,155,263	1,433,975	3,552,539	1,997,529	12,167,182
Allowance for loan and lease losses	56,824	103,886	19,981	30,861	78,668	290,220
Allowance for loan and lease losses to principal balance	5.53%	2.50%	1.39%	0.87%	3.94%	2.39%

Total portfolio, excluding loans held for sale						
Principal balance of loans	$1,580,207	$4,338,606	$1,564,933	$3,621,496	$1,997,529	$13,102,771
Allowance for loan and lease losses	135,279	126,746	32,621	34,432	78,668	407,746
Allowance for loan and lease losses to principal balance	8.56%	2.92%	2.08%	0.95%	3.94%	3.11%

	As of December 31, 2008					
(Dollars in thousands)	**Construction Loans**	**Commercial Loans**	**Comercial Mortgage Loans**	**Residential Mortgage Loans**	**Consumer and Finance Leases**	**Total**
SFAS 114 - Specific Reserves						
Principal balance of loans	$ 280,640	$ 134,998	$ 65,682	$ 19,909	$	$ 501,229
Allowance for loan and lease losses	56,330	18,343	8,680			83,353
Allowance for loan and lease losses to principal balance	20.07%	13.59%	13.22%	0.00%		16.63%
SFAS 5 - General Allowance						
Principal balance of loans	1,246,355	4,290,450	1,470,076	3,461,416	2,108,363	12,576,660
Allowance for loan and lease losses	27,152	56,015	9,095	15,016	90,895	198,173
Allowance for loan and lease losses to principal balance	2.18%	1.31%	0.62%	0.43%	4.31%	1.58%
Total portfolio, excluding loans held for sale						
Principal balance of loans	$1,526,995	$4,425,448	$1,535,758	$3,481,325	$2,108,363	$13,077,889
Allowance for loan and lease losses	83,482	74,358	17,775	15,016	90,895	281,526
Allowance for loan and lease losses to principal balance	5.47%	1.68%	1.16%	0.43%	4.31%	2.15%

Provision for Loan and Lease Losses

The provision for loan and lease losses amounted to $235.2 million, or 181% of net charge-offs, for the second quarter of 2009, compared to $41.3 million, or 140% of net charge-offs for the second quarter of 2008. For the six-month period ended June 30, 2009, the provision for loan and lease losses amounted to $294.6 million compared to $87.1 million for the comparable period in 2008. The increase in the provision for loan and leases losses is attributable to the following: i) the migration of a substantial portion of loans to the substandard or doubtful category, thus requiring higher general or specific reserves (if also considered impaired); ii) changes in reserve factors used to determine the general reserve for the Corporation s construction, commercial and residential mortgage loan portfolios; and iii) specific reserves for some of these loans classified as impaired during the second quarter of 2009.

The provision for loan losses related to the migration of loans to the substandard or doubtful category was approximately $103.3 million, or 44%, of the provision recorded in the second quarter of 2009. As before mentioned, the increase in the provision for loan and lease losses is also from the result of changes in reserve factors used to determine the general reserve for the Corporation s construction, commercial and residential mortgage loan portfolios, in both the Puerto Rico and Florida portfolios, specific reserves necessary for additional loans classified as impaired during 2009, and the overall growth of the Corporation s loan portfolio. The increase in general reserve factors was necessary to account for increases in charge-offs and delinquency levels. General reserves are established based on trends in charge-offs and delinquencies (refer to methodology explanations above).

In terms of geography, the provision for loan losses related to the Corporation s Florida operations amounted to $85.7 million and $100.8 million for the second quarter and first six-months of 2009, respectively, compared to $3.7 million and $19.0 million, respectively, for the comparable periods in 2008. The construction loan portfolio in Florida has been adversely affected by declining collateral values that resulted in increases in charge-offs (refer to net charge-offs discussion below for additional information). The provision for loan and lease losses recorded for the Corporation s Puerto Rico operations, which loan portfolio represents approximately 81% of the Corporation s total loans receivable, amounted to $141.2 million and $179.5 million for the second quarter and first six-months of 2009, respectively, compared to $37.3 million and $52.6 million, respectively, for the comparable periods in 2008, mainly related to the construction and commercial loan portfolios. The construction and commercial loan portfolios in Puerto Rico continue to be negatively impacted by further deterioration of economic and housing conditions, reflected in a persistent decline in the volume of sales of new housing units in Puerto Rico and an unemployment rate of over 14%.

Table of Contents

Net Charge-offs and Total Credit Losses

The Corporation s net charge-offs for the second quarter and first half of 2009 were $129.9 million or 3.85% of average loans on an annualized basis and $168.4 million or 2.52% of average loans on an annualized basis, respectively, compared to $29.5 million or 0.97% of average loans and $55.0 million or 0.91% of average loans, respectively, for the comparable periods in 2008. The increase is due mainly to the accelerated deterioration in the collateral values of construction loans, primarily in the Florida region. The Florida s economy has been hampered by a deteriorated housing market since the second half of 2007. The overbuilding in the face of waning demand, among other things, has caused a decline in the housing prices. The Corporation has been obtaining appraisals and increasing its reserve, as necessary, with expectations for a gradual housing market recovery. Nonetheless, the passage of time has increased the possibility that the recovery of the market will not be in the near term. For these reasons, the Corporation decided to charge-off collateral deficiencies for a significant amount of collateral dependent loans based on current appraisals obtained. The deficiencies in the collateral raise doubts about the potential to collect the principal, although many of these borrowers are making interest payments. The Corporation is engaged in continuous efforts to identify alternatives that enable borrowers to repay their loans and protect the Corporation s investment.

Construction loans net charge-offs increased by $80.3 million ($60.7 million for Florida operations) compared to the second quarter of 2008 and by $85.1 million ($58.7 million for Florida operations) compared to the first half of 2008. Commercial loans net charge-offs increased by $17.1 million compared to the second quarter of 2008 and by $20.8 million compared to the first half of 2008, mainly in Puerto Rico. Residential loans net charge-offs increased by $2.2 million compared to the second quarter of 2008 and by $8.1 million compared to the first half of 2008. A significant portion of charge-offs for the residential mortgage loan portfolio were related to a higher volume of foreclosed properties acquired in satisfaction of loans during 2009 and subsequent sales (within a 3-month period or less) at lower prices due to the Corporation s intent not to accumulate REO inventory. The increase in residential mortgage charge-offs was also driven by periodic analyses performed on a higher volume of past-due residential mortgage loans with high original loan-to-value ratios that consider recent trends, such as lower prices, as well as other conditions and relevant factors. The ratio of net charge-offs to average loans on the Corporation s residential mortgage loan portfolio was 0.39% for the quarter ended June 30, 2009, lower than the approximately 1.8% average charge-off rate for commercial banks in the U.S. mainland reported for the first quarter of 2009. The Puerto Rico housing market has not seen the dramatic decline in housing prices that is affecting the U.S. mainland; however, there is currently an oversupply of housing units compounded by a lower demand for housing due to diminished consumer purchasing power and confidence. Consumer loans net charge-offs (including finance leases) remained relatively stable, increasing by $0.8 million in the second quarter of 2009, as compared to the second quarter of 2008, and decreasing by $0.7 million compared to the first half of 2008.

Table of Contents

The following table presents annualized charge-offs to average loans held-in-portfolio:

	For the Quarter Ended		For the Six-Month Period Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Residential mortgage loans	0.39%	0.14%	0.61%	0.15%
Commercial loans	1.74%	0.81%	1.14%	0.57%
Construction loans	20.38%	0.68%	11.52%	0.86%
Consumer loans (1)	3.12%	3.02%	2.98%	3.11%
Total loans	3.85%	0.97%	2.52%	0.91%

(1) Includes lease financing.

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 charge-offs (annualized) to average loans held-in-portfolio by geographic segment:

	Quarter Ended		Six-Month Period Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
PUERTO RICO:				
Residential mortgage loans	0.43%	0.17%	0.65%	0.18%
Commercial loans	1.09%	0.15%	0.81%	0.25%
Construction loans	8.33%	0.08%	5.88%	0.04%
Consumer loans (1)	3.10%	2.94%	2.85%	3.08%
Total loans	1.90%	0.67%	1.55%	0.76%
VIRGIN ISLANDS:				
Residential mortgage loans	0.19%	0.09%	0.11%	0.05%
Commercial loans	5.08%	18.33%	2.75%	9.25%
Construction loans	0.00%	0.00%	0.00%	0.00%
Consumer loans	2.73%	3.41%	3.39%	3.16%
Total loans	1.69%	4.38%	1.14%	2.44%
FLORIDA OPERATIONS:				
Residential mortgage loans	0.32%	0.00%	0.88%	0.02%
Commercial loans	7.11%	0.02%	3.82%	0.01%
Construction loans	50.28%	1.60%	25.53%	2.00%
Consumer loans	5.01%	5.35%	7.56%	4.41%
Total loans	19.93%	0.81%	10.60%	0.97%

(1) Includes lease financing.

Table of Contents

Total credit losses (equal to net charge-offs plus losses on REO operations) for the second quarter and six-month period ended June 30, 2009 amounted to $136.6 million and $180.4 million, or 4.03% and 2.69% on an annualized basis to average loans and repossessed assets, respectively, in contrast to credit losses of $32.7 million, or a loss rate of 1.07%, for the second quarter of 2008 and $61.4 million, or a loss rate of 1.02% for the first half of 2008.

The following table presents a detail of the REO inventory and credit losses for the periods indicated:

Credit Loss Performance

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2009	2008	2009	2008
	(Dollars in thousands)			
REO				
REO balances, carrying value:				
Residential	$ 31,522	$ 15,698	$ 31,522	$ 15,698
Commercial	10,477	2,533	10,477	2,533
Condo-conversion projects	8,000	18,591	8,000	18,591
Construction	8,065	1,798	8,065	1,798
Total	$ 58,064	$ 38,620	$ 58,064	$ 38,620
REO activity (number of properties):				
Beginning property inventory,	205	108	155	87
Properties acquired	50	42	124	74
Properties disposed	(40)	(31)	(64)	(42)
Ending property inventory	215	119	215	119
Average holding period (in days)				
Residential	198	197	198	197
Commercial	90	162	90	162
Condo-conversion projects	487	116	487	116
Construction	229	101	229	101
	222	151	222	151
REO operations (loss) gain:				
Market adjustments and (losses) gain on sale:				
Residential	$ (1,924)	$ (401)	$ (5,109)	$ (845)
Commercial	(44)	(754)	(443)	(669)
Condo-conversion projects	(1,500)		(1,500)	
Construction	(502)		(965)	(22)
	(3,970)	(1,155)	(8,017)	(1,536)
Other REO operations expenses	(2,656)	(2,017)	(3,984)	(4,892)

Net Loss on REO operations	$ (6,626)	$ (3,172)	$ (12,001)	$ (6,428)
CHARGE-OFFS				
Residential charge-offs, net	(3,329)	(1,129)	(10,491)	(2,368)
Commercial charge-offs, net	(27,967)	(10,865)	(35,874)	(15,037)
Construction charge-offs, net	(82,847)	(2,526)	(91,370)	(6,311)
Consumer and finance leases charge-offs, net	(15,794)	(15,026)	(30,626)	(31,296)
Total charge-offs, net	(129,937)	(29,546)	(168,361)	(55,012)
TOTAL CREDIT LOSSES (1)	$ (136,563)	$ (32,718)	$ (180,362)	$ (61,440)
LOSS RATIO PER CATEGORY (2):				
Residential	0.61%	0.18%	0.89%	0.20%
Commercial	1.74%	0.86%	1.16%	0.59%
Construction	20.65%	0.68%	11.71%	0.85%
Consumer	3.10%	3.01%	2.97%	3.10%
TOTAL CREDIT LOSS RATIO (3)	**4.03%**	**1.07%**	**2.69%**	**1.02%**

(1) Equal to REO operations (losses) gains plus Charge-offs, net.

(2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of REO divided by average loans and repossessed assets.

(3) Calculated as net charge-offs plus net loss on REO operations divided by average loans and repossessed assets.

Table of Contents

Impaired Loans

As of June 30, 2009 and December 31, 2008, impaired loans and their related allowance were as follows:

	As of June 30, 2009	As of December 31, 2008
	(In thousands)	
Impaired loans with valuation allowance, net of charge-offs	$ 647,390	$ 384,914
Impaired loans without valuation allowance, net of charge-offs	288,199	116,315
Total impaired loans	$ 935,589	$ 501,229
Allowance for impaired loans	$ 117,526	$ 83,353

The loans that were classified as impaired during the first half of 2009, totaled approximately $614.0 million ($368.3 million pertained to Florida operations). These loans required a specific reserve of $83.9 million. Partially offsetting the increase in impaired loans were charge-offs of approximately $26.5 million related to the $614 million of loans classified as impaired during 2009 and approximately $93.3 million associated with impaired loans identified prior to 2009 and other decreases, including loans paid in full, partial payments and collateral repossessions, mainly in Florida. During the first half of 2009, the Corporation repossessed approximately $9.2 million of commercial real estate properties in Florida, net of charge-offs of approximately $8.2 million.

Approximately $64.7 million, or 54%, of the charge-offs for impaired loans recorded during 2009 are related to the construction loan portfolio in Florida and $26.3 million, or 22%, are related to the construction loan portfolio in Puerto Rico.

About 85%, or $372.4 million of the Corporation s total exposure to construction loans in Florida has been individually measured for impairment purposes and recorded at its realizable value as of June 30, 2009.

Table of Contents

The following table sets forth an analysis of the activity in the allowance for impaired loans for the six-month period ended June 30, 2009:

	For the Six-Month Period Ended June 30, 2009				
	Construction Loans	Commercial Loans	Commercial Mortgage Loans	Other Loans (1)	Total
Allowance for impaired loans, beginning of period	$ 56,330	$ 18,343	$ 8,680	$	$ 83,353
Provision for impaired loans	113,185	19,463	17,796	3,571	154,015
Charge-offs	(91,060)	(14,946)	(13,836)		(119,842)
Allowance for impaired loans, end of period	$ 78,455	$ 22,860	$ 12,640	$ 3,571	$ 117,526

(1) Mainly related to restructured residential mortgage loans.

Given the discouraging economic outlook in the Corporation s main markets and in spite of the actions taken, the Corporation may experience further deterioration in its portfolios, which may result in higher credit losses and additions to reserve balances.

Non-accruing and Non-performing Assets

Total non-performing assets are the sum of non-accruing loans, foreclosed real estate and other repossessed properties as well as non-performing investment securities. Non-accruing loans are those loans on which the accrual of interest is discontinued. When a loan is placed in non-accruing status, any interest previously recognized and not collected is reversed and charged against interest income.

Non-accruing Loans Policy

Residential Real Estate Loans The Corporation classifies real estate loans in non-accruing 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-accruing status when interest and principal have not been received for a period of 90 days or more or when there are doubts about the potential to collect all of the principal based on collateral deficiencies or, in other situations, when collection of all of principal or interest is not expected due to deterioration in the financial condition of the borrower. 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.

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

Other Real Estate Owned (OREO)

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 off the real estate at the date of acquisition (estimated realizable value).

Table of Contents

Other Repossessed Property

The other repossessed property category 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.

Investment Securities

This category presents investment securities reclassified to non-accruing status, at their book value.

Past Due Loans

Past due loans are accruing loans which are contractually delinquent 90 days or more. Past due loans are either current as to interest but delinquent in the payment of principal or are insured or guaranteed under applicable FHA and VA programs.

During the third quarter of 2007, the Corporation started a loan loss mitigation program providing homeownership preservation assistance. Loans modified through this program are reported as non-performing loans and interest is recognized on a cash basis. When there is reasonable assurance of repayment and the borrower has made payments over a sustained period, the loan is returned to accruing status.

The following table presents non-performing assets as of the dates indicated:

(Dollars in thousands)	**June 30, 2009**	**December 31, 2008**
Non-accruing loans:		
Residential real estate	$ 399,844	$ 274,923
Commercial and commercial real estate	219,409	144,301
Construction	506,642	116,290
Finance leases	5,474	6,026
Consumer	39,979	45,635
	1,171,348	587,175
REO (1)	58,064	37,246
Other repossessed property	12,732	12,794
Investment securities (2)	64,543	
Total non-performing assets	$ 1,306,687	$ 637,215
Past due loans 90 days and still accruing	$ 190,399	$ 471,364
Non-performing assets to total assets	6.53%	3.27%
Non-accruing loans to total loans receivable	8.94%	4.49%
Allowance for loan and lease losses	$ 407,746	$ 281,526
Allowance to total non-accruing loans	34.81%	47.95%

Allowance to total non-accruing loans, excluding residential real estate loans	52.85%	90.16%

(1) As of June 30, 2009 and December 31, 2008, REO include approximately $17.3 million and $14.8 million, respectively, of foreclosed properties in the U.S. mainland.

(2) Collateral pledged with Lehman Brothers Special Financing, Inc.

115

Total non-performing assets as of June 30, 2009 were $1.3 billion, compared to $637.2 million as of December 31, 2008. The increase in non-performing assets since December 31, 2008 was led by an increase of $367.8 million in loans classified as non-performing in the state of Florida, mainly construction loans, an increase of $97.7 million in non-performing residential mortgage loans in Puerto Rico, an increase of $85.0 million in non-performing construction loans in Puerto Rico and an increase of $41.3 million in non-performing commercial loans in Puerto Rico. Also, during the second quarter of 2009, the Corporation classified as non-performing investment securities with a book value of $64.5 million that were pledged to Lehman Brothers Special Financing, Inc., in connection with several interest rate swap agreements entered into with that institution. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation decided to classify such investments as non-performing. Other increases in non-performing assets mainly consist of additions to repossessed properties, mainly additions to the real estate owned portfolio, which increased by $20.8 million. Partially offsetting the aforementioned increases was a decrease of $5.2 million in non-performing consumer loans (including finance leases) in Puerto Rico.

The main reason for the increase in non-performing assets of the Florida operations was the construction loan portfolio. As of June 30, 2009, the Corporation classified approximately $348.5 million as non-performing construction loans in the state of Florida, an increase of $307.4 million compared to $41.1 million as of December 31, 2008. Collateral deficiencies on these loans may raise doubts about the ultimate ability to collect on the principal in the current economic environment, however, at the close of the second quarter of 2009 approximately $123.1 million of the loans comprising the increase in non-performing construction loans in Florida were current or had delinquencies of less than 90 days in their interest payments and expected collections will be recorded on a cash basis going forward. As sales continue to lag, some borrowers reverted to rental projects, as a result of which payment of principal and/or interest has come from rental income and other sources. In most of these loans, cash collections cover interest plus property taxes, insurance and other operating costs associated with the projects.

Total non-performing assets in Puerto Rico amounted to $814.1 million as of June 30, 2009, compared to $512.6 million as of December 31, 2008. The increase is primarily related to the residential mortgage and construction loan portfolios. Since December 31, 2008, non-performing residential mortgage loans in Puerto Rico increased by $97.7 million, reflecting the recessionary conditions in Puerto Rico s economy. Additionally, $33.8 million of the increase in non-performing residential mortgage loans relates to loans acquired in the previously explained transaction with R&G.

Meanwhile, the construction loan portfolio accounted for $85.0 million, or 39% of the total increase in non-performing loans in Puerto Rico since March 2009. Approximately $36.3 million, or 43%, of the increase pertained to two lending relationships in Puerto Rico, dedicated to the development of residential properties. The Corporation is evaluating restructuring alternatives to mitigate losses and enable borrowers to repay their loans under revised terms seeking to preserve the value of the Corporation s interests over the long-term.

In contrast to the above, non-performing consumer assets (including finance leases) decreased by $6.2 million compared to December 31, 2008 balances. This portfolio continues to show signs of stability and benefited from changes in underwriting standards implemented in late 2005. The consumer loan portfolio with an average life of approximately four years has been replenished by new originations under revised standards.

The allowance to non-performing loans ratio as of June 30, 2009 was 34.81%, compared to 47.95% as of December 31, 2008. The decrease in the ratio is attributable in part to non-performing collateral dependent loans that are evaluated individually for impairment that, after charging-off $119.8 million in the first half of 2009 representing the excess of the recorded investment in the loan over the fair value of the collateral, reflected limited impairment or no impairment at all, and other impaired loans that did not require specific reserves based on analyses conducted under SFAS 114. Also 21% of the increase in non-performing loans since December 31, 2008 is related to residential mortgage loans, mainly in Puerto Rico, where the Corporation s loan loss experience has been comparatively low due to, among other things, the Corporation s conservative underwriting practices and loan-to-value ratios, thus requiring a lower general reserve as compared to other portfolios. Approximately $33 million or 6% of the total increase in non-performing loans is attributed to non-performing residential mortgage loans acquired as part of the previously explained transaction with R&G.

The Corporation continues to provide homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico. Due to the nature of the borrower s financial condition, the restructure or loan modification through this program as well as the restructuring of other individual commercial loans, commercial mortgage loans, construction loans and residential mortgages in the U.S. mainland fits the definition of Troubled Debt Restructuring (TDR) as defined by SFAS 15, Accounting by Debtors and Creditors of Troubled Debt Restructurings. Such restructures are identified as TDRs and accounted for based on the provisions SFAS 114, Accounting by Creditors for Impairment of a Loan. As of June 30, 2009, the Corporation s TDR loans consisted of $56.9 million residential mortgage loans, $25.1 million commercial loans, $44.5 million commercial mortgage loans and $104.0 million of construction loans. From the $230.6 million total TDR loans, approximately $54.1 million are in compliance with modified terms, $28.9 million are 30-89 days delinquent, $15.1 million are 90 days past-due and still accruing and $132.5 million are classified as non-accrual as of June 30, 2009.

In view of current conditions in the Unites States mainland housing market and weakening economic conditions in Puerto Rico, the Corporation may experience further deterioration in its portfolio, in particular the commercial, construction and residential loan portfolios.

Table of Contents

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, legal and compliance, the Corporation has specialized groups, such as the Legal Department, Information Security, Corporate Compliance, Information Technology 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.

Table of Contents

Legal and Compliance Risk

Legal and compliance risk includes the risk of non-compliance 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 it 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 reasonably 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.

119

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding market risk to which the Corporation is exposed, see the information contained under the caption 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 of June 30, 2009. Based on this evaluation, 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.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the opinion of the Company s management, the pending and threatened legal proceedings of which management is aware will not have a material adverse effect on the financial condition of the Corporation.

ITEM 1A. RISK FACTORS

For a detailed discussion of certain risk factors that could affect First BanCorp s operations, financial condition or results for future periods see the risk factors below and Item 1A, Risk Factors, in First BanCorp s 2008 Annual Report on Form 10-K.

There may be future dilution of our common stock

In January 2009, in connection with the TARP Capital Purchase Program, established as part of the Emergency Economic Stabilization Act of 2008, the Corporation issued to the U.S. Treasury 400,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series F, $1,000 liquidation preference value per share. In connection with this investment, the Corporation also issued to the U.S. Treasury a warrant to purchase 5,842,259 shares of the Corporation s common stock (the Warrant) at an exercise price of $10.27 per share. The Warrant has a 10-year term and is exercisable at any time. The exercise price and the number of shares issuable upon exercise of the Warrant are subject to certain anti-dilution adjustments.

The possible future issuance of equity securities through the exercise of the Warrant could affect the Corporation s current stockholders in a number of ways, including by:

- diluting the voting power of the current holders of common stock (the shares underlying the Warrant represent approximately 6% of the Corporation s shares of common stock as of June 30, 2009);
- diluting the earnings per share and book value per share of the outstanding shares of common stock; and
- making the payment of dividends on common stock more expensive.

Credit quality, which is continuing to deteriorate, may result in future additional losses

The quality of First BanCorp s credits has continued to be under pressure during the first half of 2009 as a result of continued recessionary conditions in Puerto Rico and the state of Florida that have led to, among other things, higher unemployment levels, much lower absorption rates for new residential construction projects and further declines in property values.

Our business depends on the creditworthiness of our customers and counterparties and the value of the assets securing our loans or underlying our investments. When the credit quality of the customer base materially decreases or the risk profile of a market, industry or group of customers changes materially, our business, financial condition, allowance levels, asset impairments, liquidity, capital and results of operations is adversely affected.

While we substantially increased our provision for loan and lease losses in the second quarter of 2009, there is no certainty that it will be sufficient to cover future credit losses in the portfolio because of continued adverse changes in the economy, market conditions or events negatively affecting specific customers, industries or markets both in Puerto Rico and Florida. We periodically review the allowance for loan and lease losses for adequacy considering economic conditions and trends, collateral values and credit quality indicators, including charge-off experience and levels of past due loans and non-performing assets.

As of June 30, 2009, the Company recognized OTTI on its private label MBS. Valuation and OTTI determinations will continue to be affected by external market factors including default rates, severity rates and macro-economic factors. First BanCorp s future results may be materially affected by worsening defaults and severity rates related to the underlying collateral.

Legislative and regulatory actions taken now or in the future as a result of the current crisis in the financial industry may significantly affect our business, financial condition or results of operations

Current economic conditions, particularly in the financial markets, have resulted in government regulatory agencies and political bodies placing increased focus and scrutiny on the financial services industry. The U.S. Government has intervened on an unprecedented scale, responding to what has been commonly referred to as the financial crisis, by enhancing the liquidity support available to financial institutions, establishing a commercial paper funding facility, temporarily guaranteeing money market funds and certain types of debt issuances, and increasing insurance on bank deposits.

These programs have subjected participating financial institutions to additional restrictions, oversight and costs. In addition, new proposals for legislation continue to be introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry and impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including in the areas of compensation, interest rates, financial product offerings and disclosures, and the impact of bankruptcy proceedings on consumer residential real estate mortgages, among others. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied.

On June 17, 2009, the U.S. Treasury Department released a white paper entitled Financial Regulatory Reform A New Foundation: Rebuilding Financial Regulation and Supervision, which outlined the Obama administration s plan to make extensive and

wide ranging reforms to the U.S. financial regulatory system. The plan contains proposals to, among other things, (i) create a new financial regulatory agency called the Consumer Financial Protection Agency, (ii) eliminate the federal thrift charter and create a new national bank supervisor, (iii) dispose of the interstate branching framework of the Riegle-Neal Act by giving national and state-chartered banks the unrestricted ability to branch across state lines, (iv) establish strengthened capital and prudential standards for banks and bank holding companies, (v) increase supervision and regulation of large financial firms, and (vi) create an Office of National Insurance within the U.S. Treasury Department. We cannot predict the substance or impact of pending or future legislation, regulation or the application thereof. Compliance with such current and potential regulation and scrutiny may significantly increase our costs, impede the efficiency of our internal business practices, require us to increase our regulatory capital and limit our ability to pursue business opportunities in an efficient manner.

We also expect to face increased regulation and regulatory scrutiny as a result of our participation in the TARP Capital Purchase Program. In January 2009, we issued preferred stock and warrants to purchase our common stock to the U.S. Treasury under the TARP Capital Purchase Program. Pursuant to the terms of this issuance, we are prohibited from increasing the dividend rate on our common stock in an amount exceeding the last quarterly cash dividend paid per share, or the amount publicly announced (if lower), of common stock prior to October 14, 2008, which was $0.07 per share without approval. Furthermore, as long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including our common stock, are prohibited unless all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions.

On January 21, 2009, the U.S. House of Representatives approved legislation amending the TARP provisions of Emergency Economic Stabilization Act (EESA) to include quarterly reporting requirements with respect to lending activities, examinations by an institution s primary federal regulator of the use of funds and compliance with program requirements, restrictions on acquisitions by depository institutions receiving TARP funds, and authorization for U.S. Treasury to have an observer at board meetings of recipient institutions, among other things. On February 17, 2009, President Obama signed into law the American Reinvestment and Recovery Act of 2009 (ARRA). ARRA contains expansive new restrictions on executive compensation for financial institutions and other companies participating in the TARP Capital Purchase Program. ARRA amends the executive compensation and corporate governance provisions of EESA. In doing so, it continues all the same compensation and governance restrictions and adds substantially to restrictions in several areas. In addition, on June 10, 2009, the U.S. Treasury issued regulations implementing the compensation requirements under ARRA. The regulations became applicable to existing TARP Capital Purchase Program recipients upon publication in the Federal Register on June 15, 2009, but are subject to comment during a period scheduled to end on August 14, 2009. In addition, Congress may adopt other legislation impacting financial institutions that obtain funding under the TARP or changing lending practices that legislators believe led to the current economic situation. The new legal requirements and the adoption of any additional requirements could restrict or require

changes to our lending, executive compensation or governance practices, increase governmental oversight of our businesses and adversely affect our ability to retain senior officers.

Our suspension of dividends could adversely affect our stock price and result in the expansion of our Board

In March of 2009, the Board of Governors of the Federal Reserve System issued a supervisory guidance letter intended to provide direction to bank holding companies (BHCs) on the declaration and payment of dividends, capital redemptions, and capital repurchases by BHCs in the context of their capital planning process. The letter reiterates the long standing Federal Reserve supervisory policies and guidance to the effect that BHCs should only pay dividends from current earnings. More specifically, the March 2009 letter heightens expectations that a BHC will inform and consult with the Federal Reserve supervisory staff on the declaration and payment of dividends that exceed earnings for the period for which the dividend is being paid. In consideration of the financial results reported for the second quarter ended June 30, 2009, the Corporation decided, as a matter of prudent fiscal management and following the Federal Reserve guidance, to suspend payment of common stock dividends and dividends on all series of preferred stock. The Corporation cannot predict if or when the payments of dividends can be reinstated.

This suspension could adversely affect the Corporation s stock price. Further, if dividends on the preferred stock issued to the U.S. Treasury under the TARP Capital Purchase Program are not paid for six quarterly dividend periods or more, the authorized number of directors of the board will be increased by two and the U.S. Treasury, along with holders of parity stock, will have the right to elect the two additional members of the board of directors until all accrued and unpaid dividends for all past dividend periods have been declared and paid in full.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

For the discussion of the Corporation s Annual Stockholders Meeting held on April 28, 2009, refer to Part II, Item 4 in the Corporation s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

10.1 Employment Agreement Orlando Berges

12.1 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.

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:

	First BanCorp. Registrant
Date: August 10, 2009	By: /s/ Luis M. Beauchamp Luis M. Beauchamp Chairman, President and Chief Executive Officer
Date: August 10, 2009	By: /s/ Orlando Berges Orlando Berges Executive Vice President and Chief Financial Officer