FIRST BANCORP /PR/
Form 10-K
March 01, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark one)

[X] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended December 31, 2018

or

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

For the transition period from ___________________ to ___________________

Commission File Number 001-14793

FIRST BANCORP.

(Exact name of registrant as specified in its charter)

Puerto Rico	**66-0561882**
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	Identification No.)
1519 Ponce de León Avenue, Stop 23 **Santurce, Puerto Rico** (Address of principal executive office)	**00908** (Zip Code)

Registrant's telephone number, including area code:

(787) 729-8200

Securities registered pursuant to Section 12(b) of the Act:

Common Stock ($0.10 par value)	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A (CUSIP: 318672201);

8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B (CUSIP: 318672300);

7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C (CUSIP: 318672409);

7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D (CUSIP: 318672508); and

7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E (CUSIP: 318672607)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Se−curities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13 (a) of the Exchange Act.

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 30, 2018 (the last trading day of the registrant's most recently completed second fiscal quarter) was $1,614,392,244 based on the closing price of $7.65 per share of the registrant's common stock on the New York Stock Exchange on June 30, 2018. The registrant had no nonvoting common equity outstanding as of June 30, 2018. For the purposes of the foregoing calculation only, the registrant has defined affiliates to include (a) the executive officers named in Part III of this Annual Report on Form 10-K; (b) all directors of the registrant; and (c) each shareholder, including the registrant's employee benefit plans but excluding shareholders that file on Schedule 13G, known to the registrant to be the beneficial owner of 5% or more of the outstanding shares of common stock of the registrant as of June 30, 2018. The registrant's response to this item is not intended to be an admission that any person is an affiliate of the registrant for any purposes other than this response.

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date: 217,238,369 shares as of February 15, 2019.

Documents incorporated by reference: Portions of the definitive proxy statement relating to the registrant’s annual meeting of stockholders scheduled to be held on May 16, 2019 are incorporated by reference in this Form 10-K in response to items 10, 11, 12, 13 and 14 of Part III.

FIRST BANCORP.
2018 ANNUAL REPORT ON FORM 10-K

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Forward Looking Statements

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

First BanCorp. wishes to caution readers not to place undue reliance on any such "forward-looking statements," which speak only as of the date made, and to advise readers that these forward-looking statements are not guarantees of future performance and involve certain risks, uncertainties, estimates, and assumptions by us that are difficult to predict. Various factors, some of which are beyond our control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements.

Factors that could cause results to differ from those expressed in the Corporation's forward-looking statements include, but are not limited to, risks described or referenced below in Part I, Item 1A, "Risk Factors" and the following:

- changes in economic and business conditions, including those caused by past or future natural disasters, that directly or indirectly affect the financial health of the Corporation's customer base in the geographic areas we serve;

- the actual pace and magnitude of economic recovery in the Corporation's service areas that were affected by Hurricanes Irma and Maria during 2017 compared to management's current views on the economic recovery;

- uncertainty as to the ultimate outcomes of actions taken, or those that may be taken, by the Puerto Rico government, or the oversight board established by the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA") to address the Commonwealth of Puerto Rico's financial problems, including the filing of a form of bankruptcy under Title III of PROMESA, which provides a court debt restructuring process similar to U.S. bankruptcy protection, and the effects of measures included in the Puerto Rico government fiscal plan, or any revisions to it, on our clients and loan portfolios;

- uncertainty about whether the Federal Reserve Bank of New York (the “New York FED” or “Federal Reserve”) will continue to provide approvals for receiving dividends from FirstBank Puerto Rico (“FirstBank” or the “Bank”), making payments of dividends on non-cumulative perpetual preferred stock and common stock, or payments on trust-preferred securities or subordinated debt, incurring, increasing or guaranteeing debt or repurchasing any capital securities, despite the consents that have enabled the Corporation to receive quarterly dividends from FirstBank since the second quarter of 2016, to pay quarterly interest payments on the Corporation’s subordinated debentures associated with its trust-preferred securities since the second quarter of 2016, to pay monthly dividends on the non-cumulative perpetual preferred stock since December 2016, and to pay quarterly dividends on common stock since December 2018;

- a decrease in demand for the Corporation’s products and services resulting in lower revenues and earnings because of the continued economic recession in Puerto Rico;

- uncertainty as to the availability of certain funding sources, such as brokered certificates of deposit (“brokered CDs”);

- the Corporation’s reliance on brokered CDs to fund operations and provide liquidity;

- the risk of not being able to fulfill the Corporation’s cash obligations in the future due to the Corporation’s need to receive regulatory approvals to declare or pay any dividends and to take dividends or any other form of payment representing a reduction in capital from FirstBank or FirstBank’s failure to generate sufficient cash flow to make a dividend payment to the Corporation;

- the weakness of the real estate markets and of the consumer and commercial sectors and their impact on the credit quality of the Corporation’s loans and other assets, which have contributed and may continue to contribute to, among other things, high levels of non-performing assets, charge-offs and provisions for loan and lease losses, and may subject the Corporation to further risk from loan defaults and foreclosures;

- the ability of FirstBank to realize the benefits of its net deferred tax assets;

- adverse changes in general economic conditions in Puerto Rico, the United States ("U.S."), the U.S. Virgin Islands ("USVI"), and the British Virgin Islands ("BVI"), including the interest rate environment, market liquidity, housing absorption rates, real estate prices, and disruptions in the U.S. capital markets, which may reduce interest margins, affect funding sources and demand for all of the Corporation's products and services, and reduce the Corporation's revenues and earnings and the value of the Corporation's assets;

- an adverse change in the Corporation's ability to attract new clients and retain existing ones;

- the risk that additional portions of the unrealized losses in the Corporation's investment portfolio are determined to be other-than-temporary, including additional impairments on the Corporation's remaining $8.2 million exposure to Puerto Rico government's debt securities held as part of the available-for-sale securities portfolio;

- uncertainty about legislative, tax or regulatory changes that affect financial services companies in Puerto Rico, the U.S., the USVI and the BVI, which could affect the Corporation's financial condition or performance and could cause the Corporation's actual results for future periods to differ materially from prior results and anticipated or projected results;

- changes in the fiscal and monetary policies and regulations of the U.S. federal government and the Puerto Rico and other governments, including those determined by the Board of the Governors of the Federal Reserve System (the "Federal Reserve Board"), the New York FED, the Federal Deposit Insurance Corporation (the "FDIC"), government-sponsored housing agencies, and regulators in Puerto Rico and the USVI and BVI;

- the risk of possible failure or circumvention of controls and procedures and the risk that the Corporation's risk management policies may not be adequate;

- the Corporation's ability to identify and address cyber-security risks such as data security breaches, malware, "denial of service" attacks, "hacking" and identify theft, a failure of which could disrupt our business and result in the disclosure of and/or misuse or misappropriation of confidential or proprietary information, disruption or damage to our systems, increased costs, losses or adverse effect to our reputation;

- the risk that the FDIC may increase the deposit insurance premium and/or require special assessments to replenish its insurance fund, causing an additional increase in the Corporation's non-interest expenses;

- the impact on the Corporation’s results of operations and financial condition of acquisitions and dispositions;

- a need to recognize impairments on the Corporation’s financial instruments, goodwill and other intangible assets relating to acquisitions;

- the effect of a continued rising interest rate scenario on the Corporation’s businesses, business practices and results of operations;

- the risk that the impact of the occurrence of any of these uncertainties on the Corporation’s capital would preclude further growth of the Bank and preclude the Corporation’s Board of Directors from declaring dividends;

- uncertainty as to whether FirstBank will be able to continue to satisfy its regulators regarding, among other things, its asset quality, liquidity plans, maintenance of capital levels and compliance with applicable laws, regulations, and related requirements; and

- general competitive factors and industry consolidation.

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

Investors should refer to Item 1A. Risk Factors, in this Annual Report on Form 10-K, for a discussion of these factors and certain risks and uncertainties to which the Corporation is subject.

PART I

First BanCorp., incorporated under the laws of the Commonwealth of Puerto Rico, is sometimes referred to in this Annual Report on Form 10-K as “the Corporation,” “we,” “our” or “the registrant.”

Item 1. Business

GENERAL

First BanCorp. is a publicly owned financial holding company that is subject to regulation, supervision and examination by Federal Reserve Board. The Corporation was incorporated under the laws of the Commonwealth of Puerto Rico to serve as the bank holding company for FirstBank. The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the U.S., the USVI and the BVI. As of December 31, 2018, the Corporation had total assets of $12.2 billion, total deposits of $9.0 billion, and total stockholders’ equity of $2.0 billion.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2018, the Corporation controlled two wholly-owned subsidiaries: FirstBank and FirstBank Insurance Agency, Inc. (“FirstBank Insurance Agency”). FirstBank is a Puerto Rico-chartered commercial bank, and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency.

FirstBank is subject to the supervision, examination and regulation of both the Office of the Commissioner of Financial Institutions of Puerto Rico (“OCIF”) and the FDIC. Deposits are insured through the FDIC Deposit Insurance Fund. In addition, within FirstBank, the Bank’s USVI operations are subject to regulation and examination by the United States Virgin Islands Banking Board; its BVI operations are subject to regulation by the British Virgin Islands Financial Services Commission; and its operations in the state of Florida are subject to regulation and examination by the Florida Office of Financial Regulation. The Consumer Financial Protection Bureau (“CFPB”) regulates FirstBank’s consumer financial products and services. FirstBank Insurance Agency is subject to the supervision, examination and regulation of the Office of the Insurance Commissioner of the Commonwealth of Puerto Rico and operates four offices in Puerto Rico, and two offices in the USVI and the BVI.

As of December 31, 2018, FirstBank conducts its business through its main office located in San Juan, Puerto Rico, 46 banking branches in Puerto Rico, 11 banking branches in the USVI and the BVI, and 10 banking branches in the state of Florida (USA). As of December 31, 2018, FirstBank has 6 wholly owned subsidiaries with operations in Puerto Rico: First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company specializing in the origination of small loans with 28 offices in Puerto Rico; First Management of Puerto Rico, a domestic corporation, which holds tax-exempt assets; FirstBank Puerto Rico Securities, Corp. (“FirstBank Securities”), a subsidiary formerly engaged in broker-dealer activities; FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico; and two other companies that hold and operate certain other real estate owned (“OREO”) properties. On August 1, 2018, the Bank’s Board of Directors approved a resolution to dissolve the broker-dealer subsidiary FirstBank Securities. Accordingly, FirstBank Securities filed the required Form BDW for the withdrawal of its registration from the SEC and the Financial Industry Regulatory Authority and its license to operate as broker-dealer was terminated effective September 30, 2018. Management is in the process of completing the dissolution of FirstBank Securities as a legal entity under the state laws.

BUSINESS SEGMENTS

The Corporation has six reportable segments: Commercial and Corporate Banking; Consumer (Retail) Banking; Mortgage Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. These segments are described below as well as in Note 35, “Segment Information,” to the consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K.

Commercial and Corporate Banking

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 in Puerto Rico. FirstBank has developed expertise in a wide variety of industries. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. A substantial portion of the commercial and corporate banking portfolio is secured by the underlying value of the real estate collateral and the personal guarantees of the borrowers. This segment also includes the Corporation's broker-dealer activities.

Consumer (Retail) Banking

The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through FirstBank's branch network in Puerto Rico. Loans to consumers include auto, boat and personal loans, credit cards, and lines of credit. Deposit products include interest-bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts (IRA) and retail certificates of deposit ("retail CDs"). Retail deposits gathered through each branch of FirstBank's retail network serve as one of the funding sources for the lending and investment activities. Other activities included in this operating segment are finance leases and insurance agency activities in Puerto Rico.

Mortgage Banking

These operations consist of the origination, sale, and servicing of a variety of residential mortgage loan products and related hedging activities in Puerto Rico. Originations are sourced through different channels, such as FirstBank branches and purchases from mortgage bankers, and in association with new project developers. The Mortgage Banking segment focuses on originating residential real estate loans, some of which conform to Federal Housing Administration (the "FHA"), Veterans Administration (the "VA") and Rural Development (the "RD") standards. Loans originated that meet the FHA's standards qualify for the FHA's insurance program whereas loans that meet the standards of the VA and RD are guaranteed by those respective federal agencies.

Mortgage loans that do not qualify under these programs are commonly referred to as conventional loans. Conventional real estate loans can be conforming or non-conforming. Conforming loans are residential real estate loans that meet the standards for sale under the Fannie Mae ("FNMA") and Freddie Mac ("FHLMC") programs whereas loans that do not meet those standards are referred to as non-conforming residential real estate loans. The Corporation's strategy is to penetrate markets by providing customers with a variety of high quality mortgage products to serve their financial needs through a faster and simpler process and at competitive prices. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. Residential real estate conforming loans are sold to investors like FNMA and FHLMC. Most of the Corporation’s residential mortgage loan portfolio consists of fixed-rate, fully amortizing, full documentation loans. The Corporation has commitment authority to issue Government National Mortgage Association (“GNMA”) mortgage-backed securities. Under this program, the Corporation has been selling FHA/VA mortgage loans into the secondary market since 2009.

Treasury and Investments

The Treasury and Investments segment is responsible for the Corporation’s treasury and investment management functions. The treasury function, which includes funding and liquidity management, lends funds to the Commercial and Corporate Banking, Mortgage Banking, and the Consumer (Retail) Banking segments to finance their respective lending activities and borrows from those segments. Funds not gathered by the different business units are obtained by the Treasury function through wholesale channels, such as brokered deposits, advances from the Federal Home Loan Bank (“FHLB”), and repurchase agreements involving investment securities, among others.

United States Operations

The United States Operations segment consists of all banking activities conducted by FirstBank on the U.S. mainland. FirstBank provides a wide range of banking services to individual and corporate customers, primarily in southern Florida through 10 banking branches. The United States Operations segment offers an array of both consumer and commercial banking products and services. Consumer banking products include checking, savings and money market accounts, retail CDs, internet banking services, residential mortgages, home equity loans, lines of credit, and automobile loans. Retail deposits, as well as FHLB advances and brokered CDs assigned to this operation, serve as funding sources for its lending activities. Deposits gathered through FirstBank’s branches in the U.S. also serve as one of the funding sources for lending and investment activities in Puerto Rico.

The commercial banking services include checking, savings and money market accounts, retail CDs, internet banking services, cash management services, remote data capture, and automated clearing house, or ACH, transactions. Loan products include the traditional commercial and industrial and commercial real estate products, such as lines of credit, term loans and construction loans.

Virgin Islands Operations

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the USVI and the BVI, including retail and commercial banking services, with a total of 11 banking branches serving the islands in the USVI of St. Thomas, St. Croix, and St. John, and the island of Tortola in the BVI. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities.

Loans to consumers include auto, boat, lines of credit, and personal and residential mortgage loans. Deposit products include interest-bearing and non-interest bearing checking and savings accounts, IRAs, and retail CDs. Retail deposits gathered through each branch serve as the funding sources for its own lending activities.

Employees

As of February 1, 2019, the Corporation and its subsidiaries had 2,643 full-time equivalent employees. None of its employees is represented by a collective bargaining group. The Corporation considers its employee relations to be good.

SIGNIFICANT EVENTS SINCE THE BEGINNING OF 2018

Continuing effects of natural disasters affecting First BanCorp.

Two strong hurricanes affected the Corporation's service areas during September 2017. The following summarizes the more significant continuing financial repercussions of these natural disasters for the Corporation and for its major subsidiary, FirstBank.

Credit Quality and Allowance for Loan and Lease Losses

Relationship officers have continued to closely monitor the performance of hurricane-affected commercial loan customers during 2018. Information provided by these commercial loan officers and statistics on the performance of consumer and residential credits were factored into the determination of the allowance for loan and lease losses as of December 31, 2018. Although the identification and evaluation of hurricane-affected credits has been completed, management's assessment of the hurricanes' effect is still subject to uncertainties, both those specific to some individual customers, such as the resolution of insurance claims, and those applicable to the overall economic prospects of the hurricane-affected areas as a whole. During 2018, the Corporation recorded a net loan loss reserve release of approximately $16.9 million in connection with revised estimates associated with the effects of the hurricanes. The revised estimates were primarily attributable to updated assessments of financial performance and repayment prospects of certain individually-assessed commercial credits, updated payment patterns and probability of default credit risk analyses applied to consumer borrowers, and lower reserve requirements resulting from payments received during 2018 that reduced the balance of the consumer and residential mortgage loan portfolios outstanding on the dates of the hurricanes. In addition, during 2018, consumer loan charge-offs totaling $10.9 million were taken against previously established hurricane-related qualitative reserves. These charge offs were directly linked to the performance of consumer borrowers that were subject to payment deferral programs.

As of December 31, 2018, the hurricane-related qualitative allowance amounted to $19.2 million (December 31, 2017 - $55.6 million). The Corporation's approach to estimating the hurricanes' impact on credit quality is presented in Note 1, "Nature of Business and Summary of Significant Accounting Policies – Allowance for Loan and Lease Losses," to the consolidated financial statements included in Item 8 of this Form 10-K.

Disaster Response Plan Costs, Casualty Losses and Related Insurance

The Corporation has incurred a variety of costs to operate in disaster response mode, and some facilities and their contents, including certain OREO properties, were damaged by the storms. The Corporation maintains insurance for casualty losses, as well as for reasonable and necessary disaster response costs and certain revenue lost through business interruption. Insurance claim receivables were established for some of the individual costs, when incurred, based on management's understanding of the underlying coverage and when realization of the claim was deemed probable. During 2018, the Corporation reached settlement on certain insurance claims arising from the hurricanes. As a result, the Corporation received insurance proceeds of approximately $6.8 million, primarily related to repairs and maintenance costs incurred on some facilities, including certain OREO properties, $1.0 million related to recoveries of disaster response costs, and $0.8 million related to a loan receivable fully charged-off in prior periods. Recoveries from insurance proceeds in excess of losses incurred, amounting to $0.5 million for 2018, were recognized as a gain from insurance proceeds. As of December 31, 2018, the Corporation still had an insurance claim receivable of $3.4 million. Management also believes that there is a possibility that some gains will be recognized with respect to casualty and lost revenue claims in future periods, but this is contingent on reaching agreement on the Corporation's claims with the insurance carriers.

Liquidity Management

The Corporation experienced rapid accumulation of deposits after the hurricanes in the fourth quarter of 2017 and during 2018. Total deposits as of December 31, 2018, excluding brokered CDs, increased $567.0 million from December 31, 2017 and $928.5 million since September 30, 2017. The most significant increase was in non-interest-bearing demand deposits, which grew 31%, or $561.8 million, from December 31, 2017 and 51%, or $809.3 million, since September 30, 2017. Hurricane-related factors, such as the effect of disaster relief funds and settlements of insurance claims, contributed to this growth. Although management expects the balances accumulated by deposit customers in the hurricane-affected areas to reduce over time, it is difficult to predict when and to what degree, and there may be further growth as insurance claims are resolved and additional disaster-recovery funds are distributed.

Repurchase of Trust-Preferred Securities

During the first quarter of 2018, the Corporation completed the repurchase of $23.8 million of trust-preferred securities of the FBP Statutory Trust I that were auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust-preferred securities, which resulted in a commensurate reduction in the related Floating Rate Junior Subordinated Debenture. The Corporation's winning bid equated to 90% of the $23.8 million par value. The 10% discount resulted in a gain of approximately $2.3 million, which is reflected in the consolidated statement of income as a "Gain on early extinguishment of debt."

Transfer of Nonaccrual Loans Held for Investment to Held for Sale and Sales of Nonaccrual Loans

During the first and third quarters 2018, the Corporation transferred $74.4 million in nonaccrual commercial and construction loans to held for sale. The aggregate recorded investment in these loans of $96.6 million was written down to $74.4 million, which resulted in charge-offs of $22.2 million, of which $6.5 million was taken against previously-established reserves for loan losses, resulting in a charge to the provision for loan and lease losses of $15.7 million in 2018. Approximately $57.2 million of the nonaccrual commercial and construction loans transferred to loans held for sale were eventually sold during the second, third and fourth quarters of 2018, resulting in an additional net loss of $2.7 million recorded as part of “other non-interest income” in the consolidated statement of income.

U.S. Department of Treasury exercised warrant

On May 17, 2018, the U.S. Department of Treasury (the "U.S. Treasury") exercised its warrant to purchase 1,285,899 shares of the Corporation's common stock on a cashless basis, resulting in the issuance of 730,571 shares of common stock.

Reinstatement of quarterly cash common stock dividends

On November 14, 2018, for the first time since June 2009, the Corporation's Board of Directors, after receiving regulatory approval, declared a quarterly cash dividend of $0.03 per common share, which was paid on December 14, 2018, to common stockholders of record on November 30, 2018. Total cash dividends paid on shares of common stock amounted to $6.5 million for 2018 (or a dividend payout ratio per share of 6.46% for the fourth quarter of 2018). The Corporation has received regulatory approval to pay quarterly dividends on common stock through December 2019, subject to conditions established in the agreement with regulators. Thereafter, the Corporation intends to request approval in future periods to continue quarterly dividend payments on common stock.

Partial Reversal of Deferred Tax Assets Valuation Allowance

The Corporation recognized an income tax benefit of $63.2 million in the fourth quarter of 2018 related to the partial reversal of the valuation allowance recorded against the deferred tax assets of its bank subsidiary, FirstBank. The Corporation concluded that, as of December 31, 2018, it is more likely than not that FirstBank will generate sufficient taxable income within the applicable net operating loss carry-forward periods to partially realize its deferred tax assets related to net operating loss carryforwards ("NOLs") in Puerto Rico.

This conclusion, and the resulting partial reversal of the deferred tax asset valuation allowance, is based upon consideration of a number of factors, including, among others,: (i) a three-year cumulative income position; (ii) sustained periods of profitability following the hurricane events in 2017; and (iii) forecasts of future profitability, under several potential scenarios that support the partial utilization of NOLs prior to their expiration between 2021 through 2024. As a result of the partial reversal, the Corporation's deferred tax asset amounted to $319.9 million as of December 31, 2018 (net of a valuation allowance of $100.7 million, including a valuation allowance of $68.1 million against the deferred tax assets of the Corporation's banking subsidiary, FirstBank). See Note 26, "Income Taxes," in Item 8 of the consolidated financial statements included in Item 8 of this Form 10-K for a detailed discussion on the Corporation's deferred tax assets and the respective valuation allowance.

Puerto Rico Government Fiscal Situation, Government Actions, and the Corporation's exposure to the Puerto Rico Government

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, which has been in an economic recession since 2006 that has been exacerbated by the effects of Hurricanes Irma and Maria in 2017. The New Fiscal Plan approved by the PROMESA oversight board, as revised on October 23, 2018 (the "New Fiscal Plan"), projects a contraction in Puerto Rico's gross national product of 8.0% for fiscal year 2018, followed by projected growths of 7.9% and 5.5% for fiscal years 2019 and 2020, respectively. Such projected growth was based on an assumption that over $82 billion of disaster relief funding will enter the economy of Puerto Rico from federal and private sources. Of the total disaster relief funding of $82 billion, estimated amounts of approximately $66 billion are to be used for public assistance, $3 billion for individual assistance, $8 billion for private and business insurance pay outs, and $5 billion is related to other federal funding. On July 30, 2018, HUD approved a $1.5 billion disaster recovery plan submitted by the Puerto Rico government that primarily focuses on the restoration of damaged and destroyed homes, businesses and infrastructure. The disaster recovery action plan includes the following activities: (i) housing ($1 billion) – for rebuilding and repairs of damaged properties, rental assistance, and appliances; (ii) economic revitalization ($145 million) – for eligible businesses to help-revitalize the post-disaster economy, including through grants; and (iii) infrastructure ($100 million) – for repairs of the damaged infrastructure in Puerto Rico. In February 2019, the Puerto Rico governor announced that HUD authorized the disbursement and use of funds approved through the aforementioned disaster recovery plan.

The Puerto Rico Economic Activity Index (the “EDB-EAI”) in November 2018 was 120.3, close to pre-hurricane levels of 122.1 in August 2017, and a 21.5% growth compared to post-hurricane levels of 99.0 in November 2017, mainly related to interruption of the electric energy system in 2017 due to hurricanes Irma and Maria. The EDB-EAI is a coincident index of economic activity for Puerto Rico made up of four indicators (non-farm payroll employment, electric power generation, cement sales and gasoline consumption). The cement sales for November 2018 totaled 1.2 million of 94-pound bags, an increase of 6.3% over the prior month, and an annual increase of 64.3%. Estimated gasoline consumption in November 2018 was 78.1 million gallons, a 2.8% decrease when compared with October 2018, and a decrease of 6.7% compared to the same period in 2017. Electric power generation for November 2018 totaled 1,532.5 million kilowatt-hours, an increase of 3.3% over the prior month, and an annual increase of 94.7% compared with the same period in 2017. The revised version of the New Fiscal Plan projects that the hurricanes will create a spike in inflation of 1.6% in fiscal year 2018, with subsequent average increases of about 1.49% over the next six years, until fiscal year 2023. The seasonally adjusted unemployment rate in Puerto Rico was 8.3% in December 2018, compared to 11.0% in December 2017. The Puerto Rico labor force participation rate was 40.8% as of December 2018. The average of the labor force participation rate in Puerto Rico was 45.05% from 1990 until 2017, reaching an all-time high of 49.80% in February of 2007 and a record low of 38.6% in October of 2017. Based on information published by the Puerto Rico government, the labor force estimate was 1.1 million people as of December 2018, a reduction of 1.4% when compared with December 2017. The New Fiscal Plan reflects a 5.5% decline in population by fiscal year 2023.

Based on information published by the Puerto Rico Treasury, the net revenues of the Puerto Rico government’s General Fund in November 2018 totaled $556.9 million, which was $16.8 million less than in November 2017, and $25.5 million over projections of the New Fiscal Plan. The net revenue to the General Fund for the first five months of fiscal year ending June 30, 2019 totaled $3,540.2 million, an increase of $611.8 million, compared with the same period of the previous fiscal year.

Government Development Bank for Puerto Rico Liquidation Plan

On July 14, 2017, the PROMESA oversight board authorized the Government Development Bank for Puerto Rico (the “GDB”) to pursue the restructuring of its debts under Title VI of PROMESA and conditionally certified the GDB’s Restructuring Support Agreement (“RSA”) under the relevant provisions of Title VI. The PROMESA oversight board’s decision was in response to a request from Puerto Rico’s Fiscal Agency and Financial Advisory Authority, dated June 30, 2017, in which the agency noted that the proposed restructuring, along with certain related settlements contemplated by the RSA, will result in an efficient wind down of the GDB’s operations and a comprehensive financial restructuring of the GDB’s obligations. The RSA provides for the organized and consensual restructuring of a substantial portion of the GDB’s liabilities, including the GDB public bonds, deposit claims by municipalities and certain non-public entities, and claims under certain GDB-issued letters of credit and guarantees. In exchange for releasing the GDB from liability relating to these claims, the claim-holders will receive new bonds to be issued by a new entity.

On April 20, 2018, the PROMESA oversight board approved the new GDB fiscal plan. The new GDB fiscal plan authorizes the recently amended terms of RSA. It also paves the way for the GDB’s operational wind-down, provides for a simplified transaction structure, and ensures equal treatment of creditors. It also offers municipalities offset rights against their deposit claims.

New Fiscal Plan

The New Fiscal Plan approved by the PROMESA oversight board, uses a six-year horizon and projects a 5.5% decline in population by fiscal year 2023. In addition, the revised New Fiscal Plan established an annual emergency reserve of $130 million for 10 years. As mentioned above, it also assumes $82 billion in disaster relief funding and projects that a $30 billion surplus will be generated through fiscal year 2033. The New Fiscal Plan includes a series of structural reforms in areas, such as: (i) human capital and labor; (ii) ease of doing business; (iii) power sector reform; and (iv) infrastructure reform. The New Fiscal Plan also proposes fiscal measures projected to drive $12.4 billion in increased revenues and reduced expenditures through fiscal year 2023 and projects that structural reforms will drive a cumulative 1.21% increase in growth by Fiscal year 2058.

Commonwealth of Puerto Rico Budget

On May 10, 2018, the Puerto Rico governor proposed the Commonwealth of Puerto Rico's budget for fiscal year 2018-2019. The proposed consolidated budget amounts to $25.3 billion and comes from the following sources:

- $8.7 billion from General Fund
- $8.1 billion from Federal Funds
- $7.5 billion from Revenue Funds
- $0.4 billion from Special State Funds
- $0.6 billion from Other Governmental Funds

The recommended General Fund budget amounted to $8.7 billion, a net decrease of $0.8 billion when compared with the budget approved for the fiscal year 2017-2018. On the other hand, the Federal Funds budgeted amount in the proposed budget shows an increase of $1.8 billion or 28% more compared with the budget for fiscal year 2017-2018. However, the PROMESA oversight board concluded that the proposed Commonwealth of Puerto Rico budget for fiscal year 2018-2019 does not comply with the Fiscal Plan approved on April 19, 2018. On June 29, 2018, the PROMESA oversight board stated that, because of the Puerto Rico government's failure to enact labor reform, including the repeal of the law on unjustified work dismissals (Law 80), it had certified a new revised version of the New Fiscal Plan that reflects, among others changes, a reduction of the projected 30-year surplus of the central government to $14.4 billion from the previous projection between $39 billion to $40 billion, the elimination of Christmas bonuses for public employees, and lower funding for infrastructure and municipalities.

On June 30, 2018, the PROMESA oversight board certified a revised budget for fiscal year 2019 that outlines expenditures of $8.8 billion from the General Fund and $20.7 billion from the consolidated budget.

On July 5, 2018, the Puerto Rico government filed a lawsuit seeking declaratory judgment that clarifies the PROMESA oversight board's power over the Commonwealth's budget.

On August 7, 2018, the U.S. District Judge Laura Taylor Swain ruled that the PROMESA oversight board has the power to enforce fiscal discipline through the budgetary process, but lacks authority to demand changes in laws.

Puerto Rico Tax Reform of 2018 – Law Act 257

On December 10, 2018, the Governor of Puerto Rico signed into Law Act 257 (the “Puerto Rico Tax Reform of 2018” or “Act 257”), which amends numerous provisions of the Puerto Rico Internal Revenue Code of 2011, including, among others, (i) a reduction in the Puerto Rico corporate tax rate from 39% to 37.5%; (ii) an increase in the net operating and capital losses usage limitation from 80% to 90%; (iii) amendments to the provisions related to “pass-through” entities that provide that corporations that own 50% or more of a partnership will not be able to claim a current or carryover non partnership NOL deduction against a partnership distributable share, and (iv) other limitations on certain deductions such as meals and entertainment deductions. As a result of the enactment of Act 257, the Corporation recorded in the fourth quarter of 2018 a one-time charge to income tax expense of $9.9 million related to the remeasurement of the Corporation’s deferred tax assets arising from the aforementioned decrease in the maximum statutory tax rate in Puerto Rico from 39% to 37.5% (net of the $5.6 million related impact in the valuation allowance). The PROMESA oversight board expressed concerns regarding certain provisions of Act 257. In particular, the PROMESA oversight board indicated that it has not received enough evidence from the Puerto Rico government to conclude that Act 257 will not negatively impact the Puerto Rico government’s fiscal Plan. It has not yet been determined whether Act 257 will be further amended to accommodate any mandate from the PROMESA oversight board. The PROMESA oversight board issued a letter to the Governor of Puerto Rico on December 27, 2018 stating that Act 257 is not in compliance with PROMESA with respect to Articles 132 through 163, regarding the video lottery terminals (VLTs) that operate outside casinos in Puerto Rico.

The Third Amended Title III Plan of Adjustment (the "COFINA plan")

On February 4, 2019, the U.S. District Judge Laura Taylor Swain, approved the COFINA plan, a restructuring agreement for bondholders of debt issued by the Puerto Rico Sales Tax Financing Corporation ("COFINA," by its Spanish acronym). The COFINA plan restructures $18.0 billion of COFINA debt, which represents 24% of Puerto Rico's funded debt. In addition, the COFINA plan reduced the annual cash flow to COFINA from a maximum of $1.8 billion to $992 million and provides to the Government of Puerto Rico an average annual savings of $425 million for the next 40 years.

Recent Developments

On February 15, 2019, the U.S. Court of Appeals for the First Circuit held that members of the PROMESA oversight board created by PROMESA are "Officers of the Unites States" subject to the U.S. Constitution's Appointments Clause and directed the district court to enter a declaratory judgement to the effect that PROMESA's protocol for the appointment of Board Members is unconstitutional.

This matter arose from the restructuring of Puerto Rico's public debt under PROMESA. In May 2017, the PROMESA oversight board exercised its authority under Title III of PROMESA to initiate debt adjustment proceedings on behalf of the Puerto Rico government. Appellants sought to dismiss the Title III proceedings, arguing that the PROMESA oversight board lacked authority to initiate them because the PROMESA oversight board members were illegally appointed in contravention of the Appointments Clause. The district court rejected Appellants' motions to dismiss. The First Circuit reversed in part, (1) the Territorial Clause does not displace the Appointments Clause in an unincorporated territory such as Puerto Rico; (2) Board Members are "Principal" "Officers of the United States" subject to the Appointments Clause; and (3) therefore, the process PROMESA provides for the appointment of Board Members is unconstitutional. The U.S. Court of Appeals for the First Circuit set a 90-day period to allow President Donald Trump and the U.S. Senate to constitutionally validate the appointments or reconstitute the PROMESA oversight board.

On February 22, 2019, the U.S. Court of Appeals for the First Circuit affirmed the district court's dismissal of Plaintiffs' complaint against the PROMESA oversight board and its members and executive director alleging that the PROMESA oversight board had exceeded its power under PROMESA during the 2019 fiscal plan and the Commonwealth of Puerto Rico's budget development and certification processes, holding that the complaint was properly dismissed.

Exposure to the Puerto Rico Government

As of December 31, 2018, the Corporation had $214.6 million of direct exposure to the Puerto Rico government, its municipalities and public corporations, compared to $214.5 million as of December 31, 2017. As of December 31, 2018, approximately $191.9 million of the exposure consisted of loans and obligations of municipalities in Puerto Rico that are supported by assigned property tax revenues and for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment, compared to $184.6 million as of December 31, 2017. Approximately 75% of the Corporation's municipality exposure consisted primarily of senior priority obligations concentrated in three of the largest municipalities in Puerto Rico. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. The PROMESA oversight board has not designated any of the Commonwealth's 78 municipalities as covered entities under PROMESA. However, while the revised fiscal plan certified by the PROMESA oversight board did not contemplate a restructuring of the debt of Puerto Rico's municipalities, the plan did call for the gradual elimination of budgetary subsidies provided to municipalities. Furthermore, municipalities are also likely to be affected by the negative economic and other effects resulting from expense, revenue or cash management measures taken to address the Puerto Rico government's fiscal and liquidity shortfalls, as well as measures included in fiscal plans of other government entities. In addition to municipalities, the Corporation's total direct exposure included a $14.5 million loan to an affiliate of the Puerto Rico Electric Power Authority ("PREPA") and obligations of the Puerto Rico government, specifically bonds of the Puerto Rico Housing Finance Authority, at an amortized cost of $8.2 million as part of its available-for-sale investment securities portfolio (fair value of $7.0 million as of December 31, 2018).

In addition, as of December 31, 2018, the Corporation had $112.1 million in exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to $75 million of the principal under the mortgage loan insurance program. According to the most recently-released audited financial statements of the Puerto Rico Housing Finance Authority, as of June 30, 2016, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans in an aggregate of approximately $576 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loan insurance fund. As of June 30, 2016, the most recent date as to which information is available, the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately $77.4 million.

As of December 31, 2018, the Corporation had $677.3 million of public sector deposits in Puerto Rico, compared to $490.3 million as of December 31, 2017. Approximately 34% is from municipalities and municipal agencies in Puerto Rico and 66% is from public corporations and the central government and agencies in Puerto Rico.

During 2018, the Corporation reached resolution on the three commercial mortgage loans granted to the hotel industry in Puerto Rico that were formerly guaranteed by the Puerto Rico Tourism Development Fund ("TDF"). Historically, the borrower and the operations of the underlying collateral of these loans were the primary sources of repayment and the TDF, which is a subsidiary of the GDB, provided a secondary guarantee for payment performance. The Corporation sold in 2018 two of these three loans that carried an aggregate book value of $27.2 million (net of cumulative charge-offs of $22.0 million), realizing an additional loss of $2.7 million at the time of sale. In addition, the largest of these three facilities was paid-off during the fourth quarter of 2018. This facility carried a book value of $28.8 million (net of cumulative charge-offs of $28.4 million) and a loan loss recovery of $7.4 million was recorded at the time of the repayment in 2018. The sales and repayments of such loans resulted in a $70.8 million reduction in nonaccrual loans during 2018.

WEBSITE ACCESS TO REPORT

The Corporation makes available annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports and proxy statements on Schedule 14A, filed or furnished pursuant to section 13(a), 14(a) or 15(d) of the Exchange Act, free of charge on or through its internet website at www.1firstbank.com (under "Investor Relations"), as soon as reasonably practicable after the Corporation electronically files such material with, or furnishes it to, the SEC.

The Corporation also makes available the Corporation's corporate governance guidelines and principles, the charters of the audit, asset/liability, compensation and benefits, credit, compliance, risk, corporate governance and nominating committees and the codes of conduct and independence principles mentioned below, free of charge on or through its internet website at www.1firstbank.com (under "Investor Relations"):

- Code of Ethics for CEO and Senior Financial Officers
- Code of Ethics applicable to all employees
- Corporate Governance Standards
- Independence Principles for Directors

The corporate governance guidelines and principles and the aforementioned charters and codes may also be obtained free of charge by sending a written request to Mr. Lawrence Odell, Executive Vice President and General Counsel, PO Box 9146, San Juan, Puerto Rico 00908.

MARKET AREA AND COMPETITION

Puerto Rico, where the banking market is highly competitive, is the main geographic service area of the Corporation. As of December 31, 2018, the Corporation also had a presence in the state of Florida and in the USVI and the BVI. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States mainland.

Competitors include other banks, insurance companies, mortgage banking companies, small loan companies, automobile financing companies, leasing companies, brokerage firms with retail operations, and credit unions in Puerto Rico, the Virgin Islands and the state of Florida. The Corporation's businesses compete with these other firms with respect to the range of products and services offered and the types of clients, customers and industries served.

The Corporation's ability to compete effectively depends on the relative performance of its products, the degree to which the features of its products appeal to customers, and the extent to which the Corporation meets clients' needs and expectations. The Corporation's ability to compete also depends on its ability to attract and retain professional and other personnel, and on its reputation.

The Corporation encounters intense competition in attracting and retaining deposits and in its consumer and commercial lending activities. The Corporation competes for loans with other financial institutions, some of which are larger and have greater resources available than those of the Corporation. Management believes that the Corporation has been able to compete effectively for deposits and loans by offering a variety of account products and loans with competitive features, by pricing its products at competitive interest rates, by offering convenient branch locations, and by emphasizing the quality of its service. The Corporation's ability to originate loans depends primarily on the rates and fees charged and the service it provides to its borrowers in making prompt credit decisions. There can be no assurance that in the future the Corporation will be able to continue to increase its deposit base or originate loans in the manner or on the terms on which it has done so in the past.

SUPERVISION AND REGULATION

Most of the regulations required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") now have been adopted. Although there is a possibility of additional Dodd-Frank Act-related regulations in the future, the pace of new regulations under the Dodd-Frank Act is expected to abate. Future legislation, however, may increase the regulation and oversight of the Corporation and FirstBank, although it is also possible that future legislation could reduce the regulatory compliance obligations of FirstBank and the Corporation. Any change in applicable laws or regulations, however, may have a material adverse effect on the business of commercial banks and bank holding companies, including FirstBank and the Corporation.

Dodd-Frank Act

The Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes numerous provisions that have affected and will affect large and small financial institutions alike, including banks and bank holding companies and how they will be regulated in the future. As a result of the Dodd-Frank Act, there has been and will be in the future additional regulatory oversight and supervision of the Corporation and its subsidiaries.

The Dodd-Frank Act, among other things, imposes new capital requirements on bank holding companies; provides that a bank holding company must serve as a source of financial and managerial strength to each of its subsidiary banks and stand ready to commit resources to support each of them; changes the base for FDIC insurance assessments to a bank's average consolidated total assets minus average tangible equity, rather than its deposit base, and permanently raises the current standard deposit insurance limit to $250,000; and expands the FDIC's authority to raise insurance premiums. The legislation also calls for the FDIC to raise the ratio of reserves to deposits from 1.15% to 1.35% for deposit insurance purposes by September 30, 2020 and to "offset the effect" of increased assessments on insured depository institutions with assets of less than $10 billion.

The CFPB, which was created by the Dodd-Frank Act, has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards, and contains provisions on mortgage-related matters such as steering incentives and determinations as to a borrower's ability to repay the principal amount and prepayment penalties.

The CFPB has primary examination and enforcement authority over FirstBank and other banks with over $10 billion in assets with respect to consumer financial products and services.

The Dodd-Frank Act also limits interchange fees payable on debit card transactions. The Federal Reserve Board's current debit card interchange rule caps a debit card issuer's base fee at 21 cents per transaction and allows an additional 5 basis-point charge per transaction to help cover fraud losses. The debit card interchange rule has reduced our interchange fee revenue in line with industry-wide expectations since 2011.

The Dodd-Frank Act includes provisions that affect corporate governance and executive compensation at all publicly-traded companies and allows financial institutions to pay interest on business checking accounts. The legislation also restricts proprietary trading, places restrictions on the owning or sponsoring of hedge and private equity funds, and regulates the derivatives activities of banks and their affiliates.

Section 171 of the Dodd-Frank Act (the "Collins Amendment"), among other things, eliminates certain trust-preferred securities from Tier I capital. Preferred securities issued under the U.S. Treasury's Troubled Asset Relief Program ("TARP") are exempt from this treatment. Bank holding companies, such as the Corporation, were required to fully phase out these instruments from Tier 1 capital by January 1, 2016; however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature.

Regulatory Capital and Liquidity Coverage Developments.

The federal banking agencies adopted new rules for U.S. banks that revise important aspects of the minimum regulatory capital requirements, the components of regulatory capital, and the risk-based capital treatment of bank assets and off-balance sheet exposures. The final rules, which currently apply to the Corporation and FirstBank, generally are intended to align U.S. regulatory capital requirements with international regulatory capital standards adopted by the Basel Committee on Banking Supervision ("Basel Committee"), in particular the most recent international capital accord adopted in 2010 (and revised in 2011) known as "Basel III." The current rules increase the quantity and quality of capital required by, among other things, establishing a minimum common equity capital requirement and an additional common equity Tier 1 capital conservation buffer. In addition, the current rules revise and harmonize the bank regulators' rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses that have been identified, by applying a variation of the Basel III "standardized approach" for the risk-weighting of bank assets and off-balance sheet exposures to all U.S. banking organizations other than large internationally active banks.

Consistent with Basel III and the Collins Amendment, the current rules also establish a more conservative standard for including an instrument such as trust-preferred securities as Tier 1 capital for bank holding companies with total consolidated assets of $15 billion or more as of December 31, 2009. Bank holding companies such as the Corporation were required to fully phase out these instruments from Tier I capital by January 1, 2016, although qualifying trust-preferred securities may be included as Tier 2 capital until the instruments are redeemed or mature. As of December 31, 2018, the Corporation had $178.6 million in trust-preferred securities that are subject to a full phase-out from Tier 1 capital under the final regulatory capital rules discussed above. During the first quarter of 2018, the Corporation completed the repurchase of $23.8 million of trust-preferred securities of the FBP Statutory Trust I that were auctioned in a public sale at which the Corporation was invited to participate. This transaction is described in more detail in "Significant Events Since the Beginning of 2018" above.

The current capital rules became effective for the Corporation and our subsidiary bank on a multi-year transitional basis starting on January 1, 2015, and, in general, are fully effective as of January 1, 2019, although certain elements of the new rules have been deferred by the federal banking agencies. The new general minimum regulatory capital requirements and the "standardized approach" for risk weighting of a banking organization's assets, however, fully apply to us. The rules have increased our regulatory capital requirements and require us to hold more capital against certain of our assets and off-balance sheet exposures. The Corporation's estimated pro-forma common equity Tier 1 ratio, Tier 1 capital ratio, total capital ratio, and the leverage ratio under the Basel III rules, giving effect as of December 31, 2018 to all the provisions that were deferred, were 19.86%, 20.26%, 23.50%, and 15.37%, respectively. These ratios would exceed the fully phased-in minimum capital ratios under Basel III.

These regulatory capital requirements are discussed in further detail in "Regulation and Supervision – Bank and Bank Holding Company Regulatory Capital Requirements."

International Regulatory Capital and Liquidity Coverage Developments

International regulatory developments can affect the regulation and supervision of U.S. banking organizations, including the Corporation and FirstBank. Both the Basel Committee and the Financial Stability Board (established in April 2009 by the Group of Twenty ("G-20") Finance Ministers and Central Bank Governors) have agreed to take action to strengthen regulation and supervision of the financial system with greater international consistency, cooperation and transparency, including the adoption of Basel III and a commitment to raise capital standards and liquidity buffers within the banking system under Basel III.

In late 2014, the Basel Committee issued its final requirements for a Net Stable Funding Ratio ("NSFR"). The NSFR compares the amount of an institution's available stable funding ("ASF", the ratio's numerator) to its required stable funding ("RSF", the ratio's denominator) to measure how the institution's asset base is funded. ASF is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. While the NSFR is intended to be applied to large, internationally active banks, at the discretion of national supervisors it can be applied to other banking organizations or classes of banking organizations. As proposed by the U.S. federal banking agencies in May 2016, however, the NSFR requirements would not apply to the Corporation.

Consumer Financial Protection Bureau.

CFPB regulations issued over the past few years implement the Dodd-Frank Act amendments to the Equal Credit Opportunity Act, the Truth in Lending Act ("TILA"), and the Real Estate Settlement Procedures Act ("RESPA"). In general, among other changes, these regulations collectively: (i) require lenders to make a reasonable good faith determination of a prospective residential mortgage borrower's ability to repay based on specific underwriting criteria and set standards related to the determination by mortgage lenders of a consumer's ability to repay the mortgage; (ii) require stricter underwriting of "qualified mortgages," discussed below, that presumptively satisfies the ability to pay requirement (thereby providing the lender a safe harbor from non-compliance claims); (iii) specify new limitations on loan originator compensation and establish criteria for the qualifications of, and registration or licensing of, loan originators; (iv) further restrict certain high-cost mortgage loans by expanding the coverage of the Home Ownership and Equity Protections Act of 1994; (v) expand mandated loan escrow accounts for certain loans; (vi) revise existing appraisal requirements under the Equal Credit Opportunity Act and require provision of a free copy of all appraisals to applicants for first lien loans; (vii) establish new appraisal standards for most "higher-risk mortgages" under TILA; (viii) combine in a single, new form required loan disclosures under TILA and RESPA; (ix) define a "qualified mortgage" for purposes of the Dodd Frank Act; and (x) afford safe harbor legal protections for lenders making qualified loans that are not "higher priced."

The CFPB also has issued regulations setting forth new mortgage servicing rules that apply to the Bank.

The regulations affect notices given to consumers as to delinquency, foreclosure alternatives and loss mitigation, modification applications, interest rate adjustments and options for avoiding "force-placed" insurance. Servicers are prohibited from processing foreclosures when a loan modification is pending, and must wait until a loan is more than 120 days delinquent before initiating a foreclosure action.

The servicer must provide direct and ongoing access to its personnel, and provide prompt review of any loss mitigation application. Servicers must maintain accurate and accessible mortgage records for the life of a loan and until one year after the loan is paid off or transferred.

In October 2016, the CFPB adopted further changes to these mortgage servicing rules. These changes generally clarify and amend provisions regarding force-placed insurance notices, policies and procedures, early intervention, loss mitigation requirements and periodic statement requirements under the CFPB mortgage servicing rules. The amendments also address proper compliance regarding certain servicing requirements when a consumer is a potential or confirmed successor in interest, is in bankruptcy, or sends a cease communication request under the Fair Debt Collection Practices Act. These amendments became generally effective in October 2017, although provisions relating to successors-in-interest and periodic statements when a consumer is in bankruptcy became effective in April 2018. These new mortgage servicing standards added to our costs of conducting a mortgage servicing business.

The Dodd-Frank Act directs the CFPB to publish rules and forms that combine certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan under the TILA and the RESPA. Consistent with this requirement, the CFPB has amended Regulation X (Real Estate Settlement Procedures Act) and Regulation Z (Truth in Lending) to establish new disclosure requirements and forms in Regulation Z for most closed-end consumer credit transactions secured by real property. In addition to combining the existing disclosure requirements and implementing new requirements imposed by the Dodd-Frank Act, the rule provides extensive guidance regarding compliance with those requirements.

Under new leadership (Michael Mulvaney, who was appointed acting Director of the CFPB in November 2017, and more recently Kathy Kraninger, who was confirmed as permanent Director in December 2018), however, the CFPB has taken and may continue to take regulatory actions that may have material deregulatory effects, including the reconsideration of existing CFPB regulations, and an assessment of the effectiveness of other regulatory actions. The nature, scope and impact of these actions, however, and their impact on the Corporation and FirstBank, cannot be predicted at this time.

Economic Growth, Regulatory Relief, and Consumer Protection Act.

In May 2018, President Trump signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"). EGRRCPA makes a number of changes to the Dodd-Frank Act and other federal banking laws that were generally intended to be deregulatory in nature. While many of the more significant changes apply to large banking organizations and not to mid-size banking organizations such as the Corporation, other provisions of EGRRCPA make changes to certain banking law requirements that we believe will help reduce our regulatory burden, including:

- Prohibiting federal banking regulators from imposing higher regulatory capital requirements on High Volatility Commercial Real Estate (“HVCRE”) exposures unless they are for acquisition, development or construction (“ADC”), and clarifying ADC status;
- Exempting from federal mortgage appraisal requirements certain transactions involving real property in rural areas and valued at less than $400,000; and
- Directing the CFPB to provide guidance on the applicability of the TILA-RESPA Integrated Disclosure rule to mortgage assumption transactions and construction-to-permanent home loans, as well the extent to which lenders can rely on model disclosures that do not reflect recent regulatory changes.

Since EGRRCPA’s enactment, the federal banking agencies (the Federal Reserve Board, FDIC and the Office of the Comptroller of the Currency) have taken rulemaking and other actions to implement the legislation’s requirements, and are expected to continue doing so in 2019. Despite these changes, most provisions of the Dodd-Frank Act and its implementing regulations remain in place and will continue to result in additional operating and compliance costs that could have a material adverse effect on our business, financial condition, results of operation.

Dodd-Frank Act Stress Tests ("DFAST").

On July 6, 2018, bank regulatory agencies issued a joint interagency statement regarding the impact of EGRRCPA on, among other things, the Dodd-Frank Act stress-testing requirements applicable to bank holding companies and other financial companies. According to the interagency statement, EGRRCPA gave immediate relief from the company-run stress testing requirements for bank holding companies with total consolidated assets of less than $100 billion, but the agencies have extended the deadlines for all regulatory requirements related to company-run stress testing for depository institutions with average total consolidated assets of less than $100 billion until November 25, 2019. In turn, the federal banking agencies have proposed rule changes that, among other things, fully implement the asset threshold increase for company-run stress tests. Pursuant to direction from the regulators, the Corporation was provided similar relief and is no longer required to submit company-run annual stress tests. Notwithstanding these amendments to the stress testing requirements, the federal banking agencies indicated through interagency guidance that the capital planning and risk management practices of institutions with total assets less than $100 billion would continue to be reviewed through the regular supervisory process. Although the Corporation will continue to monitor its capital consistent with the safety and soundness expectations of the federal regulators, the Corporation will no longer conduct company-run stress testing as a result of the legislative and regulatory amendments. The Corporation continues to use customized stress testing to support the business and as part of its capital planning process.

The Volcker Rule.

This section of the Dodd-Frank Act, subject to important exceptions, generally prohibits a banking entity such as the Corporation or FirstBank from acquiring or retaining any ownership in, or acting as sponsor to, a hedge fund or private equity fund ("covered fund"). The Volcker Rule also prohibits these entities from engaging, for their own account, in short-form proprietary trading of certain securities, derivatives, commodity futures and options on these instruments.

Final regulations implementing the Volcker Rule have been adopted by the financial regulatory agencies and are now generally effective.

The Corporation and the Bank are not engaged in proprietary trading as defined in the Volcker Rule. In addition, a review of the Corporation's investments was undertaken to determine if any meet the Volcker Rule's definition of covered funds. Based on that review, the Corporation's investments are not considered covered funds under the Volcker Rule.

Community Reinvestment Act and Home Mortgage Disclosure Act Regulations.

The Community Reinvestment Act ("CRA") encourages banks to help meet the credit needs of the local communities in which the banks offer their services, including low- and moderate-income individuals, consistent with the safe and sound operation of the bank.

The CRA requires the federal supervisory agencies, as part of the general examination of supervised banks, to assess the bank's record of meeting the credit needs of its community, assign a performance rating, and take such record and rating into account in their evaluation of certain applications by such bank. The CRA also requires all institutions to make public disclosure of their CRA ratings. FirstBank received a "satisfactory" CRA rating in its most recent examination by the FDIC.

Failure to adequately serve the communities could result in the denial by the regulators of proposals to merge, consolidate or acquire new assets, as well as expand or relocate branches.

The federal bank regulatory agencies have amended their respective CRA regulations primarily to conform to changes made by the CFPB to Regulation C, which implements the Home Mortgage Disclosure Act ("HMDA").

Since 1995, the Federal Reserve Board, the FDIC, and the Office of the Comptroller of the Currency have conformed certain definitions in their respective CRA regulations to the scope of loans reported under Regulation C and believe that continuing to do so produces a less burdensome CRA performance evaluation process. In particular, the agencies have amended their CRA regulations to revise the definitions of "home mortgage loan" and "consumer loan," as well as the public file content requirements. These revisions maintain consistency between the CRA regulations and amendments to Regulation C, which generally became effective on January 1, 2018.

In addition, the final rule contains technical corrections and removes obsolete references to the Neighborhood Stabilization Program.

The amendments to the CRA regulations also became effective on January 1, 2018.

***Future Legislation and Regulation*.**

While the federal agencies have adopted regulations that implement many requirements of the Dodd-Frank Act, important regulatory actions (e.g., the adoption of rules regarding the compensation of financial institutions executives) that could have an impact on the Corporation and the Bank remain to be taken. Additional consumer protection laws may be enacted, and the FDIC, Federal Reserve and CFPB have adopted and may adopt in the future new regulations that have addressed or may address, among other things, banks' credit card, overdraft, collection, privacy and mortgage lending practices. Additional consumer protection regulatory activity is possible in the near future.

Any proposals and legislation, if finally adopted and implemented, would change banking laws and our operating environment and that of our subsidiaries in ways that could be substantial and unpredictable. We cannot determine whether such proposals and legislation will be adopted, or the ultimate effect that such proposals and legislation, if enacted, or regulations issued to implement the same, would have upon our financial condition or results of operations.

Bank Holding Company Activities and Other Limitations

The Corporation is registered and subject to regulation under the Bank Holding Company Act of 1956, as amended (the "Bank Holding Company Act" or "BHC Act"). Under the provisions of the Bank Holding Company Act, a bank holding company must obtain Federal Reserve Board approval before it acquires direct or indirect ownership or control of more than 5% of the voting shares of another bank, or merges or consolidates with another bank holding company. The Federal Reserve Board also has authority under certain circumstances to issue cease and desist orders, and assess substantial civil money penalties, against bank holding companies and their non-bank subsidiaries. In addition, the Corporation is subject to ongoing regulation, supervision, and examination by the Federal Reserve Board, and is required to file with the Federal Reserve Board periodic and annual reports and other information concerning its own business operations and those of its subsidiaries.

A bank holding company is prohibited under the Bank Holding Company Act, with limited exceptions, from engaging, directly or indirectly, in any business unrelated to the businesses of banking or managing or controlling banks. One of the exceptions to these prohibitions permits ownership by a bank holding company of the shares of any corporation if the Federal Reserve Board, after due notice and opportunity for hearing, by regulation or order has determined that the activities of the corporation in question are so closely related to the businesses of banking or managing or controlling banks as to be a proper incident thereto.

The Bank Holding Company Act also permits a bank holding company to elect to become a financial holding company and engage in a broad range of activities that are financial in nature. The Corporation filed an election with the Federal Reserve Board and became a financial holding company under the Bank Holding Company Act. Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Bank Holding Company Act specifically provides that the following activities have been determined to be "financial in nature": (a) lending, trust and other banking activities; (b) insurance activities; (c) financial or economic advice or services; (d) pooled investments; (e) securities underwriting and dealing; (f) domestic activities permitted for existing bank holding company; (g) foreign activities permitted for existing bank holding company; and (h) merchant banking activities.

A financial holding company that ceases to meet certain standards is subject to a variety of restrictions, depending on the circumstances, including precluding the undertaking of new activities or the acquisition of shares or control of other companies. Until compliance is restored, the Federal Reserve Board has broad discretion to impose appropriate limitations on the financial holding company's activities. If compliance is not restored within 180 days, the Federal Reserve Board may ultimately require the financial holding company to divest its depository institutions or, in the alternative, to discontinue or divest any activities that are not permitted to non-financial holding company bank holding companies. The Corporation and FirstBank must be well-capitalized and well-managed for regulatory purposes, and FirstBank must earn "satisfactory" or better ratings on its periodic CRA examinations to preserve the financial holding company status. The Corporation currently is restricted in its ability to engage in new activities or the acquisition of shares or control of other companies without the prior written approval of the Federal Reserve Board

The potential restrictions are different if the lapse pertains to the CRA. In that case, until all the subsidiary institutions are restored to at least a "satisfactory" CRA rating status, the financial holding company may not engage, directly or through a subsidiary, in any of the additional financial activities permissible under the Bank Holding Company Act or make additional acquisitions of companies engaged in the additional activities. However, completed acquisitions and additional activities and affiliations previously begun are left undisturbed, as the Bank Holding Company Act does not require divestiture for this type of situation.

Under provisions of the Dodd-Frank Act and Federal Reserve Board policy, a bank holding company such as the Corporation is expected to act as a source of financial and managerial strength to its banking subsidiaries and to commit support to them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment.

In addition, any capital loans by a bank holding company to any of its subsidiary banks must be subordinated in right of payment to deposits and to certain other indebtedness of such subsidiary bank. As of December 31, 2018, and the date hereof, FirstBank was and is the only depository institution subsidiary of the Corporation. The Dodd-Frank Act directs the Federal Reserve Board to adopt regulations adopting the statutory source-of-strength requirements, but implementing regulations have not yet been proposed.

USA PATRIOT Act and Other Anti-Money Laundering Requirements.

As a regulated depository institution, FirstBank is subject to the Bank Secrecy Act, which imposes a variety of reporting and other requirements, including the requirement to file suspicious activity and currency transaction reports that are designed to assist in the detection and prevention of money laundering, terrorist financing and other criminal activities. In addition, under Title III of the USA PATRIOT Act of 2001, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions are required to, among other things, identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Presently, only certain types of financial institutions (including banks, savings associations and money services businesses) are subject to final rules implementing the anti-money laundering program requirements of the USA PATRIOT Act.

Regulations implementing the Bank Secrecy Act and the USA PATRIOT Act are published and primarily enforced by the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Treasury. Failure of a financial institution, such as the Corporation or the Bank, to comply with the requirements of the Bank Secrecy Act or the USA PATRIOT Act could have serious legal and reputational consequences for the institution, including the possibility of regulatory enforcement or other legal action, including significant civil money penalties. The Corporation also is required to comply with federal economic and trade sanctions requirements enforced by the Office of Foreign Assets Control ("OFAC"), a bureau of the U.S. Treasury. The Corporation has adopted appropriate policies, procedures and controls to address compliance with the Bank Secrecy Act, USA PATRIOT Act and economic/trade sanctions requirements, and to implement banking agency, U.S. Treasury and OFAC regulations.

In May 11, 2016, FinCEN issued its final rules under the Bank Secrecy Act to clarify and strengthen customer due diligence requirements for: Banks; brokers or dealers in securities; mutual funds; and futures commission merchants and introducing brokers in commodities (the "Rule"). The Rule contains explicit customer due diligence requirements and include a new requirement to identify and verify the identity of beneficial owners of legal entity customers, subject to certain exclusions and exemptions. Under the Rule, covered financial institutions must establish procedures to:

- Identify each natural person that directly or indirectly owns 25% or more of the equity interests of a legal entity customer (the "ownership prong");
- Identify one natural person with "significant responsibility to control, manage, or direct" a legal entity customer (the "control prong"), which may be a person reported under the ownership prong; and,
- Verify the identities of those persons according to risk-based procedures, which procedures must include the elements currently required under the Customer Identification Rule at a minimum. Identification of those beneficial owners must be conducted at the time a new account is opened.

Compliance with the Rule's requirements was mandatory by May 11, 2018 (the "Applicability Date"). FirstBank implemented the Rule by the Applicability Date.

State Chartered Non-Member Bank and Banking Laws and Regulations in General

FirstBank is subject to regulation and examination by the OCIF, the CFPB and the FDIC, and is subject to comprehensive federal and state (Commonwealth of Puerto Rico) regulations dealing with a wide variety of subjects. The federal and state laws and regulations that are applicable to banks regulate, among other things, the scope of their businesses, their investments, their reserves against deposits, the timing and availability of deposited funds, and the nature and amount of and collateral for certain loans. In addition to the impact of regulations, commercial banks are affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to influence the economy. Among the instruments used by the Federal Reserve Board to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate, and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies and regulations of the Federal Reserve Board have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our future business, earnings and growth cannot be predicted.

There are periodic examinations by the OCIF, the CFPB and the FDIC of FirstBank to test the Bank's conformance to safe and sound banking practices and compliance with various statutory and regulatory requirements. This regulation and supervision establishes a comprehensive framework and oversight of activities in which a banking institution can engage. The regulation and supervision by the FDIC are intended primarily for the protection of the FDIC's insurance fund and depositors. The regulatory structure also gives the regulatory authorities discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease-and-desist or removal orders and initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and for engaging in unsafe or unsound practices. In addition, certain bank actions are required by statute and implementing regulations. Other actions or failure to act may provide the basis for enforcement action, including the filing of misleading or untimely reports with regulatory authorities.

Written Agreement

FirstBank was notified by the FDIC that the Consent Order under which the Bank had been operating since June 2, 2010 was terminated effective April 29, 2015. FirstBank is required to maintain capital at specified levels pursuant to applicable law and its agreement with its regulators and currently exceeds all minimum capital requirements.

In October 2017, the Federal Reserve Bank of New York terminated the formal written agreement (the "Written Agreement") entered into on June 3, 2010 between the Corporation and the Federal Reserve. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock.

Dividend Restrictions

The Federal Reserve Board's "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies" (the "Supervisory Letter") discusses the ability of bank holding companies to declare dividends and to repurchase equity securities. The Supervisory Letter is generally consistent with prior Federal Reserve supervisory policies and guidance, although it places greater emphasis on discussions with the regulators prior to dividend declarations and redemption or repurchase decisions even when not explicitly required by the regulations. The Federal Reserve Board provides that the principles discussed in the letter are applicable to all bank holding companies.

The Federal Reserve Board has also issued a policy statement that, as a matter of prudent banking, a bank holding company should generally not maintain a given rate of cash dividends unless its net income available to common shareholders has been sufficient to fund fully the dividends and the prospective rate of earnings retention appears to be consistent with the organization’s capital needs, asset quality, and overall financial condition. The Corporation is subject to certain restrictions generally imposed on Puerto Rico corporations with respect to the declaration and payment of dividends (*i.e.*, that dividends may be paid out only from the Corporation’s net assets in excess of capital or, in the absence of such excess, from the Corporation’s net earnings for such fiscal year and/or the preceding fiscal year).

The principal source of funds for the Corporation’s parent holding company is dividends declared and paid by its subsidiary, FirstBank. Pursuant to its agreement with the Federal Reserve, the Corporation cannot directly or indirectly take dividends or any other form of payment representing a reduction in capital from the Bank without the prior approval of the Federal Reserve. The ability of FirstBank to declare and pay dividends on its capital stock is regulated by the Puerto Rico Banking Law, the Federal Deposit Insurance Act (the “FDIA”), and FDIC regulations. In general terms, the Puerto Rico Banking Law provides that when the expenditures of a bank are greater than receipts, the excess of expenditures over receipts shall be charged against undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If the reserve fund is not sufficient to cover such balance in whole or in part, the outstanding amount must be charged against the bank’s capital account. The Puerto Rico Banking Law provides that, until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends. In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding such bank.

On November 14, 2018, for the first time since July 2009, the Corporation's Board of Directors, after receiving regulatory approval, declared a quarterly cash dividend of $0.03 per common share, which was paid on December 14, 2018 to common stockholders of record on November 30, 2018. Total cash dividends paid on shares of common stock amounted to $6.5 million for 2018. In addition, since the fourth quarter of 2016, following receipt of the requisite regulatory approval, the Corporation has paid monthly cash dividends on its outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock. The Corporation has to date received approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock and quarterly dividends on common stock through December 2019, subject to conditions established in the agreement with regulators. Further, after December 2019, the Corporation intends to continue to request the Federal Reserve's approval to enable it to continue to pay the monthly dividends on its Series A through E Preferred Stock and quarterly dividends on common stock, although there is no assurance that any dividends will be declared on the Corporation's Series A through E Preferred Stock or common stock in any future periods So long as any shares of preferred stock remain outstanding, we cannot declare, set apart or pay any dividends on shares of our common stock unless any accrued and unpaid dividends on our preferred stock for the twelve monthly dividend periods ending on the immediately preceding dividend payment date have been paid or are paid contemporaneously and the full monthly dividend on our preferred stock for the then current month has been or is contemporaneously declared and paid or declared and set apart for payment.

Financial Privacy and Cybersecurity

The federal banking regulators have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These regulations affect how consumer information is used in diversified financial companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and application information. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services.

The federal banking regulators regularly issue guidance regarding cybersecurity intended to enhance cyber risk management standards among financial institutions. A financial institution is expected to establish multiple lines of defense and to ensure their risk management processes address the risk posed by potential threats to the institution. A financial institution's management is expected to maintain sufficient processes to effectively respond and recover the institution's operations after a cyber-attack. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations if a critical service provider of the institution falls victim to this type of cyber-attack. The Corporation's Information Security Program reflects the requirements of this guidance.

Limitations on Transactions with Affiliates and Insiders

Certain transactions between FDIC-insured banks financial institutions such as FirstBank and its affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and by Federal Reserve Regulation W. An affiliate of a bank is, in general, any corporation or entity that controls, is controlled by, or is under common control with the bank.

In a holding company context, the parent bank holding company and any companies that are controlled by such parent bank holding company are affiliates of the bank. Generally, Sections 23A and 23B of the Federal Reserve Act (i) limit the extent to which the bank or its subsidiaries may engage in “covered transactions” (defined below) with any one affiliate to an amount equal to 10% of such bank’s capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such bank’s capital stock and surplus and (ii) require that all “covered transactions” be on terms substantially the same, or at least as favorable to the bank or affiliate, as those provided to a non-affiliate. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and other similar transactions. In addition, loans or other extensions of credit by the bank to the affiliate are required to be collateralized in accordance with the requirements set forth in Section 23A of the Federal Reserve Act. The Dodd-Frank Act added derivatives and securities lending and borrowing transactions to the list of “covered transactions” subject to Section 23A restrictions.

In addition, Sections 22(h) and (g) of the Federal Reserve Act, implemented through Regulation O, place restrictions on commercial bank loans to executive officers, directors, and principal stockholders of the bank and its affiliates. Under Section 22(h) of the Federal Reserve Act bank loans to a director, an executive officer, a greater than 10% stockholder of the bank, and certain related interests of these persons, may not exceed, together with all other outstanding loans to such persons and affiliated interests, the bank's loans to one borrower limit, generally equal to 15% of the bank's unimpaired capital and surplus. Section 22(h) of the Federal Reserve Act also requires that loans to directors, executive officers, and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons and also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a bank to insiders cannot exceed the bank's unimpaired capital and surplus. Furthermore, Section 22(g) of the Federal Reserve Act places additional restrictions on loans to executive officers.

Executive Compensation

In 2010, the federal banking agencies adopted interagency guidance governing incentive-based compensation programs, which applies to all banking organizations regardless of asset size. This guidance uses a principles-based approach to ensure that incentive-based compensation arrangements appropriately tie rewards to longer-term performance and do not undermine the safety and soundness of banking organizations or create undue risks to the financial system. The interagency guidance is based on three major principles: (i) balanced risk-taking incentives; (ii) compatibility with effective controls and risk management; and (iii) strong corporate governance. The guidance further provides that, where appropriate, the banking agencies will take supervisory or enforcement action to ensure that material deficiencies that pose a threat to the safety and soundness of the organization are promptly addressed.

In May 2016, as required under section 956 of the Dodd-Frank Act, the federal banking agencies, along with other federal regulatory agencies, proposed regulations (first proposed in 2011) governing incentive-based compensation practices at covered banking institutions, which would include, among others, all banking organizations with assets of $1 billion or greater. These proposed rules are intended to better align the financial rewards for covered employees with an institution's long-term safety and soundness. Portions of these proposed rules would apply to the Corporation and FirstBank. Those applicable provisions would generally (i) prohibit types and features of incentive-based compensation arrangements that encourage inappropriate risk because they are "excessive" or "could lead to material financial loss" at the banking institution; (ii) require incentive-based compensation arrangements to adhere to three basic principles: (1) a balance between risk and reward; (2) effective risk management and controls; and (3) effective governance; and (iii) require appropriate board of directors (or committee) oversight and recordkeeping and disclosures to the banking institution's primary regulatory agency. The nature and substance of any final action to adopt these proposed rules, and the timing of any such action, are not known at this time.

Bank and Bank Holding Company Regulatory Capital Requirements

The Federal Reserve Board has adopted risk-based and leverage capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve Board's historical risk-based capital guidelines were based upon the 1988 capital accord ("Basel I") of the Basel Committee. These historical requirements, however, which included a legacy simplified risk-weighting system for the calculations of risk-based assets, as well as lower leverage capital requirements, were superseded by new risk-based and leverage capital requirements that went into effect, on a multi-year transitional basis, on January 1, 2015. The FDIC has adopted substantively identical requirements that apply to insured banks under its regulation and supervision. These requirements are part of a revised regulatory capital framework for U.S. banking organizations (the "Basel III rules") adopted by the banking agencies that is based on international regulatory capital requirements adopted by the Basel Committee over the past several years.

The Basel III rules introduced new minimum capital ratios and capital conservation buffer requirements, change the composition of regulatory capital, require a number of new adjustments to and deductions from regulatory capital, and introduced a new "Standardized Approach" for the calculation of risk-weighted assets that replaced the risk-weighting requirements under prior U.S. regulatory capital rules. The new minimum regulatory capital requirements and the Standardized Approach for the calculation of risk-weighted assets became effective for the Corporation on January 1, 2015.

Although the Corporation and FirstBank became subject to the Basel III rules beginning on January 1, 2015, certain requirements of the Basel III rules are being phased-in over several years and, in general, are effective as of January 1, 2019. Certain elements of the rules also have been deferred by the federal banking agencies. The Corporation and FirstBank compute risk-weighted assets using the Standardized Approach required by the Basel III rules.

The Basel III rules require the Corporation to maintain an additional capital conservation buffer of 2.5% to avoid limitations on both (i) capital distributions (*e.g.*, repurchases of capital instruments, dividends and interest payments on capital instruments), and (ii) discretionary bonus payments to executive officers and heads of major business lines. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional Common Equity Tier 1 Capital ("CET1"), which was progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reached the fully phased-in 2.5% CET1 requirement on January 1, 2019.

Under the fully phased-in Basel III rules, in order to be considered adequately capitalized, the Corporation is required to maintain: (i) a minimum CET1 capital to risk-weighted assets ratio of at least 4.5%, plus the 2.5% capital conservation buffer, resulting in a required minimum CET1 ratio of at least 7%; (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5%; (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5%; and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets.

In addition, the Basel III rules require a number of new deductions from and adjustments to CET1, including deductions from CET1 for certain intangible assets, and deferred tax assets dependent upon future taxable income; the four-year phase-in period for these adjustments generally began on January 1, 2015. Mortgage servicing assets and deferred tax assets attributable to temporary differences, among others, are required to be deducted to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

The Basel III rules also require that certain non-qualifying capital instruments, including cumulative preferred stock and trust preferred securities ("TRUPs"), be excluded from Tier 1 capital. In general, banking organizations such as the Corporation began to phase out TRUPs from Tier 1 capital on January 1, 2015. The outstanding balances owed on the Corporation's TRUPs were fully phased out from Tier 1 capital as of January 1, 2016. However, the Corporation's TRUPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

On November 21, 2017, the Federal Reserve Board, FDIC, and the Office of the Comptroller of the Currency finalized an extension of the phase-in of certain Basel III rules for banks not using the Basel advanced approaches. The extension, which was effective January 1, 2018, pauses the full transition to the Basel III treatment of mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions and minority interests, pending the banking agencies' broader efforts, announced in September 2017, to simply the regulatory capital rules that apply to banking organizations that are not subject to the advanced approaches capital rules. Because the advanced approaches rules apply only to banking organizations with more than $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposure, the extension relief applies broadly to community, midsize, and regional banks, including the Corporation and FirstBank.

The Corporation and FirstBank compute risk weighted assets using the Standardized Approach required by the Basel III rules. The Standardized Approach for risk-weightings has expanded the risk-weighting categories from the four major risk-weighting categories under the previous regulatory capital rules (0%, 20%, 50%, and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets. In a number of cases, the Standardized Approach results in higher risk weights for a variety of asset categories. Specific changes to the risk-weightings of assets include, among other things: (i) applying a 150% risk weight instead of a 100% risk weight for high volatility commercial real estate acquisition, development and construction loans, (ii) assigning a 150% risk weight to exposures that are 90 days past due (other than qualifying residential mortgage exposures, which remain at an assigned risk-weighting of 100%), (iii) establishing a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, in contrast to the 0% risk-weighting under the prior rules and (iv) requiring capital to be maintained against on-balance-sheet and off-balance-sheet exposures that result from certain cleared transactions, guarantees and credit derivatives, and collateralized transactions (such as repurchase agreement transactions).

Prompt Corrective Action.

The Prompt Corrective Action ("PCA") provisions of the FDIA require the federal bank regulatory agencies to take prompt corrective action against any undercapitalized insured depository institution. The FDIA establishes five capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Well-capitalized insured depository institutions ("institutions") significantly exceed the required minimum level for each relevant capital measure. Adequately capitalized institutions include institutions that meet but do not significantly exceed the required minimum level for each relevant capital measure. Undercapitalized institutions consist of those that fail to meet the required minimum level for one or more relevant capital measures. Significantly undercapitalized institutions are those with capital levels significantly below the minimum requirements for any relevant capital measure. Critically undercapitalized institutions have minimal capital and are at serious risk for government seizure.

Under certain circumstances, a well-capitalized, adequately capitalized or undercapitalized institution may be treated as if the institution were in the next lower capital category. An institution is generally prohibited from making capital distributions (including paying dividends), or paying management fees to a holding company if the institution would thereafter be undercapitalized. Institutions that are adequately capitalized but not well-capitalized cannot accept, renew or roll over brokered deposits except with a waiver from the FDIC and are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew or roll over brokered deposits.

The federal bank regulatory agencies are permitted or, in certain cases, required to take certain actions with respect to institutions falling within one of the three undercapitalized categories. Depending on the level of an institution's capital, the agencies' corrective powers include, among other things:

- prohibiting the payment of principal and interest on subordinated debt;
- prohibiting the holding company from making distributions without prior regulatory approval;
- placing limits on asset growth and restrictions on activities;
- placing additional restrictions on transactions with affiliates;
- restricting the interest rate the institution may pay on deposits;
- prohibiting the institution from accepting deposits from correspondent banks; and
- in the most severe cases, appointing a conservator or receiver for the institution.

An institution that is undercapitalized is required to submit a capital restoration plan, and such a plan will not be accepted unless, among other things, the institution's holding company guarantees the plan up to a certain specified amount. Any such guarantee from an institution's holding company is entitled to a priority of payment in bankruptcy.

The banking agencies' Basel III rules, discussed above, revise the PCA requirements by (i) introducing a separate CET1 ratio requirement for each PCA capital category (other than critically undercapitalized) with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each PCA capital category with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the previous 6%); and (iii) eliminating the previous provision that allows a bank with a composite supervisory rating of 1 to have a 3% leverage ratio and still be adequately capitalized and maintaining the minimum leverage ratio for well-capitalized status at 5%. The Basel III rules do not change the total risk-based capital requirement (10% for well-capitalized status) for any PCA capital category. The new PCA requirements became effective on January 1, 2015.

A bank's capital category, as determined by applying the prompt corrective action provisions of the law, may not constitute an accurate representation of the overall financial condition or prospects of a bank, such as the Bank, and should be considered in conjunction with other available information regarding the financial condition and results of operations of the bank.

Set forth below are the Corporation's and FirstBank's capital ratios as of December 31, 2018 based on Federal Reserve and FDIC guidelines:

		Banking Subsidiary	
	First BanCorp.	FirstBank	General Well-Capitalized Minimum
As of December 31, 2018			
Total capital (Total capital to risk-weighted assets)	24.00%	23.51%	10.00%
Common Equity Tier 1 Capital (Common Equity Tier 1 capital to risk-weighted assets)	20.30%	18.76%	6.50%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	20.71%	22.25%	8.00%
Leverage ratio (1)	15.37%	16.53%	5.00%

(1) Tier 1 capital to average assets.

Deposit Insurance

The increase in deposit insurance coverage to up to $250,000 per customer, the FDIC's expanded authority to increase insurance premiums, as well as the increase in the number of bank failures after the 2008 financial crisis, resulted in an increase in deposit insurance assessments for all banks, including FirstBank. The Dodd-Frank Act changed the requirements for the Deposit Insurance Fund by requiring that the designated reserve ratio for the Deposit Insurance Fund for any year not be less than 1.35 percent of estimated insured deposits or the comparable percentage of the new deposit assessment base. In addition, the FDIC must take steps as necessary for the reserve ratio to reach 1.35 percent of estimated insured deposits by September 30, 2020. If the reserve ratio exceeds 1.5 percent, the FDIC must dividend to Deposit Insurance Fund members the amount above the amount necessary to maintain the Deposit Insurance Fund at 1.5 percent, but the FDIC Board of Directors may, in its sole discretion, suspend or limit the declaration of payment of dividends. The FDIC has adopted a Deposit Reserve Fund restoration plan that projects that the designated reserve ratio will reach 1.35 percent by the 2020 deadline. The FDIC has also adopted a final rule raising its industry target ratio of reserves to insured deposits to 2 percent, 65 basis points above the statutory minimum, but the FDIC does not project that goal to be met for several years.

The FDIC assessment rules currently define the assessment base for deposit insurance as required by the Dodd-Frank Act, specify assessment rates, implement the Dodd-Frank Act's Deposit Insurance Fund dividend provisions, and revise the risk-based assessment system for all large insured depository institutions (institutions with at least $10 billion in total assets), such as FirstBank. In March 2016, the FDIC adopted a rule, which became effective on July 1, 2016, to increase the Deposit Insurance Fund to the statutorily required minimum level of 1.35 percent. Among other things, the rule imposes on banks with at least $10 billion in assets (which includes the Bank) a surcharge of 4.5 cents per $100 of their assessment base, after making certain adjustments.

On September 30, 2018, the Deposit Insurance Fund Reserve Ratio reached 1.36 percent, exceeding the statutorily required minimum reserve ratio of 1.35 percent ahead of the September 30, 2020, deadline required under the Dodd-Frank Act. FDIC regulations provide for two changes to deposit insurance assessments upon reaching the minimum: (1) surcharges on insured depository institutions with total consolidated assets of $10 billion or more, such as FirstBank, will cease; and (2) small banks will receive assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from between 1.15 percent and 1.35 percent, to be applied when the reserve ratio is at or above 1.38 percent.

FDIC Insolvency Authority

Under Puerto Rico banking laws (discussed below), the OCIF may appoint the FDIC as conservator or receiver of a failed or failing FDIC-insured Puerto Rican bank, such as the Bank, and the FDIA authorizes the FDIC to accept such an appointment. In addition, the FDIC has broad authority under the FDIA to appoint itself as conservator or receiver of a failed or failing state bank, including a Puerto Rican bank. If the FDIC is appointed conservator or receiver of a bank upon the bank's insolvency or the occurrence of other events, the FDIC may sell or transfer some, part or all of a bank's assets and liabilities to another bank, or liquidate the bank and pay out insured depositors, as well as uninsured depositors and other creditors to the extent of the closed bank's available assets. As part of its insolvency authority, the FDIC has the authority, among other things, to take possession of and administer the receivership estate, pay out estate claims, and repudiate or disaffirm certain types of contracts to which the bank was a party if the FDIC believes such contract is burdensome and its disaffirmance will aid in the administration of the receivership. In resolving the estate of a failed bank, the FDIC as receiver will first satisfy its own administrative expenses, and the claims of holders of U.S. deposit liabilities also have priority over those of other general unsecured creditors.

Activities and Investments

The activities as "principal" of FDIC-insured, state-chartered banks, such as FirstBank, are generally limited to those that are permissible for national banks. Similarly, under regulations dealing with equity investments, an insured state-chartered bank generally may not directly or indirectly acquire or retain any equity investments of a type, or in an amount, that is not permissible for a national bank.

Federal Home Loan Bank System

FirstBank is a member of the Federal Home Loan Bank ("FHLB") system. The FHLB system consists of eleven regional Federal Home Loan Banks governed and regulated by the Federal Housing Finance Agency. The Federal Home Loan Banks serve as reserve or credit facilities for member institutions within their assigned regions. They are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system, and they make loans (advances) to members in accordance with policies and procedures established by the FHLB system and the board of directors of each regional FHLB.

FirstBank is a member of the FHLB of New York and, as such, is required to acquire and hold shares of capital stock in the FHLB of New York in an amount calculated in accordance with the requirements set forth in applicable laws and regulations. FirstBank is in compliance with the stock ownership requirements of the FHLB of New York. All loans, advances and other extensions of credit made by the FHLB to FirstBank are secured by a portion of FirstBank's mortgage loan portfolio, certain other investments and the capital stock of the FHLB held by FirstBank.

Ownership and Control

Because of FirstBank's status as an FDIC-insured bank, as defined in the Bank Holding Company Act, the Corporation, as the owner of FirstBank's common stock, is subject to certain restrictions and disclosure obligations under various federal laws, including the Bank Holding Company Act and the Change in Bank Control Act (the "CBCA"). Regulations adopted pursuant to the Bank Holding Company Act and the CBCA generally require prior Federal Reserve Board or other federal banking agency approval or non-objection for an acquisition of control of an insured institution (as defined in the Act) or holding company thereof by any person (or persons acting in concert). Control is deemed to exist if, among other things, a person (or group of persons acting in concert) acquires 25% or more of any class of voting stock of an insured institution or holding company thereof. Under the CBCA, control is presumed to exist subject to rebuttal if a person (or group of persons acting in concert) acquires 10% or more of any class of voting stock and either (i) the corporation has registered securities under Section 12 of the Exchange Act, or (ii) no person (or group of persons acting in concert) will own, control or hold the power to vote a greater percentage of that class of voting securities immediately after the transaction. The concept of acting in concert is very broad and also is subject to certain rebuttable presumptions, including, among others, that relatives, business partners, management officials, affiliates and others are presumed to be acting in concert with each other and their businesses. The regulations of the FDIC implementing the CBCA are generally similar to those described above.

The Puerto Rico Banking Law requires the approval of the OCIF for changes in control of a Puerto Rico bank. See "Puerto Rico Banking Law."

Standards for Safety and Soundness

The FDIA requires the FDIC and the other federal bank regulatory agencies to prescribe standards of safety and soundness, by regulations or guidelines, relating generally to operations and management, asset growth, asset quality, earnings, stock valuation, and compensation. The implementing regulations and guidelines of the FDIC and the other federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. In general, the regulations and guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The regulations and guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. Failure to comply with these standards can result in administrative enforcement or other adverse actions against the bank.

Brokered Deposits

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well-capitalized institutions are not subject to limitations on brokered deposits, while adequately-capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits.

Puerto Rico Banking Law

As a commercial bank organized under the laws of the Commonwealth of Puerto Rico, FirstBank is subject to supervision, examination and regulation by OCIF pursuant to the Puerto Rico Banking Law of 1933, as amended (the “Banking Law”).

The Banking Law contains various provisions relating to FirstBank and its affairs, including its incorporation and organization, the rights and responsibilities of its directors, officers and stockholders and its corporate powers, lending limitations, capital requirements, and investment requirements. In addition, the Commissioner is given extensive rule-making power and administrative discretion under the Banking Law.

The Banking Law authorizes Puerto Rico commercial banks to conduct certain financial and related activities directly or through subsidiaries, including the leasing of personal property and the operation of a small loan business.

The Banking Law requires every bank to maintain a legal reserve, which shall not be less than twenty percent (20%) of its demand liabilities, except government deposits (federal, state and municipal) that are secured by actual collateral. The reserve is required to be composed of any of the following securities or a combination thereof: (1) legal tender of the United States; (2) checks on banks or trust companies located in any part of Puerto Rico that are to be presented for collection during the day following the day on which they are received; (3) money deposited in other banks provided said deposits are authorized by the Commissioner and subject to immediate collection; (4) federal funds sold to any Federal Reserve Bank and securities purchased under agreements to resell executed by the bank with such funds that are subject to be repaid to the bank on or before the close of the next business day; and (5) any other asset that the Commissioner identifies from time to time.

Section 17 of the Banking Law permits Puerto Rico commercial banks to make loans to any one person, firm, partnership or corporation in an aggregate amount of up to fifteen percent (15%) of the sum of: (i) the bank’s paid-in capital; (ii) the bank’s reserve fund; (iii) 50% of the bank’s retained earnings, subject to certain limitations; and (iv) any other components that the Commissioner may determine from time to time. If such loans are secured by collateral worth at least twenty-five percent (25%) of the amount of the loan, the aggregate maximum amount may reach one-third (33.33%) of the sum of the bank’s paid-in capital, reserve fund, 50% of retained earnings, subject to certain limitations, and such other components that the Commissioner may determine from time to time. There are no restrictions under the Banking Law on the amount of loans that may be wholly secured by bonds, securities and other evidences of indebtedness of the Government of the United States, or of the Commonwealth of Puerto Rico, or by bonds, not in default, of municipalities or instrumentalities of the Commonwealth of Puerto Rico.

The Banking Law prohibits Puerto Rico commercial banks from making loans secured by their own stock, and from purchasing their own stock, unless such purchase is made pursuant to a stock repurchase program approved by the

Commissioner or is necessary to prevent losses because of a debt previously contracted in good faith. The stock purchased by the Puerto Rico commercial bank must be sold by the bank in a public or private sale within one year from the date of purchase.

The Banking Law provides that no officer, director, agent or employee of a Puerto Rico commercial bank may serve as an officer, director, agent or employee of another Puerto Rico commercial bank, financial corporation, savings and loan association, trust corporation, corporation engaged in granting mortgage loans or any other institution engaged in the money lending business in Puerto Rico. This prohibition is not applicable to any such position with an affiliate of a Puerto Rico commercial bank.

The Banking Law requires that Puerto Rico commercial banks prepare each year a balance summary of their operations, and submit such balance summary for approval at a regular meeting of stockholders, together with an explanatory report thereon. The Banking Law also requires that at least ten percent (10%) of the yearly net income of a Puerto Rico commercial bank be credited annually to a reserve fund. This credit is required to be done every year until such reserve fund shall be equal to the total paid-in-capital of the bank.

The Banking Law also provides that when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts shall be charged against the undistributed profits of the bank, and the balance, if any, shall be charged against the reserve fund, as a reduction thereof. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount shall be charged against the capital account and no dividend shall be declared until said capital has been restored to its original amount and the amount in the reserve fund equals twenty percent (20%) of the original capital.

The Banking Law requires the prior approval of the Commissioner with respect to a transfer of capital stock of a bank that results in a change of control of the bank. Under the Banking Law, a change of control is presumed to occur if a person or a group of persons acting in concert, directly or indirectly, acquires more than 5% of the outstanding voting capital stock of the bank. The Commissioner has interpreted the restrictions of the Banking Law as applying to acquisitions of voting securities of entities controlling a bank, such as a bank holding company. Under the Banking Law, the determination of the Commissioner whether to approve a change of control filing is final and non-appealable.

The Finance Board, which is composed of the Commissioner, the Secretary of the Treasury, the Secretary of Commerce, the Secretary of Consumer Affairs, the President of the Economic Development Bank, the President of the Government Development Bank, and the President of the Planning Board, has the authority to regulate the maximum interest rates and finance charges that may be charged on loans to individuals and unincorporated businesses in Puerto Rico. The current regulations of the Finance Board provide that the applicable interest rate on loans to individuals and unincorporated businesses, including real estate development loans but excluding certain other personal and commercial loans secured by mortgages on real estate properties, is to be determined by free competition. Accordingly, the regulations do not set a maximum rate for charges on retail installment sales contracts, small loans, and credit card purchases and set aside previous regulations which regulated these maximum finance charges. Furthermore, there is no maximum rate set for installment sales contracts involving motor vehicles, commercial, agricultural and industrial equipment, commercial electric appliances and insurance premiums.

International Banking Act of Puerto Rico ("IBE Act 52")

The business and operations of FirstBank International Branch ("FirstBank IBE" or the "IBE division of FirstBank") and FirstBank Overseas Corporation (the IBE subsidiary of FirstBank) are subject to supervision and regulation by the Commissioner. FirstBank and FirstBank Overseas Corporation were created under the IBE Act 52, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at the corporate standard rates to the extent that the IBE's net income exceeds 20% of the bank's total net taxable income. Under the IBE Act 52, certain sales, encumbrances, assignments, mergers, exchanges or transfers of shares, interests or participation(s) in the capital of an international banking entity (an "IBE") may not be initiated without the prior approval of the Commissioner. The IBE Act 52 and the regulations issued thereunder by the Commissioner (the "IBE Regulations") limit the business activities that may be carried out by an IBE. Such activities are limited in part to persons and assets located outside of Puerto Rico.

Pursuant to the IBE Act 52 and the IBE Regulations, each of FirstBank IBE and FirstBank Overseas Corporation must maintain in Puerto Rico books and records of all its transactions in the ordinary course of business. FirstBank IBE and FirstBank Overseas Corporation are also required thereunder to submit to the Commissioner quarterly and annual reports of their financial condition and results of operations, including annual audited financial statements.

The IBE Act 52 empowers the Commissioner to revoke or suspend, after notice and hearing, a license issued thereunder if, among other things, the IBE fails to comply with the IBE Act 52, the IBE Regulations or the terms of its license, or if the Commissioner finds that the business or affairs of the IBE are conducted in a manner that is not consistent with the public interest.

In 2012, the Puerto Rico government approved Act Number 273 ("Act 273"). Act 273 replaces, prospectively, IBE Act 52 with the objective of improving the conditions for conducting international financial transactions in Puerto Rico. An IBE existing on the date of approval of Act 273, such as FirstBank IBE and FirstBank Overseas Corporation, can continue operating under IBE Act 52, or, it can voluntarily convert to an International Financial Entity ("IFE") under Act 273 so it may broaden its scope of Eligible IFE Activities, as defined below, and obtain a grant of tax exemption under Act 273.

IFEs are licensed by the Commissioner, and authorized to conduct certain Act 273 specified financial transactions ("Eligible IFE Activities"). Once licensed, an IFE can request a grant of tax exemption ("Tax Grant") from the Puerto Rico Department of Economic Development and Commerce, which will enumerate and secure the following tax benefits provided by Act 273 as contractual rights (*i.e.*, regardless of future changes in Puerto Rico law) for a fifteen (15) year period:

(i) to the IFE:

- a fixed 4% Puerto Rico income tax rate on the net income derived by the IFE from its Eligible IFE Activities; and
- full property and municipal license tax exemptions on such activities.

(ii) to its shareholders:

- 6% income tax rate on distributions to Puerto Rico resident shareholders of earnings and profits derived from the Eligible IFE Activities; and
- full Puerto Rico income tax exemption on such distributions to non-Puerto Rico resident shareholders.

The primary purpose of IFEs is to attract Unites States and foreign investors to Puerto Rico. Consequently, Act 273 authorizes IFEs to engage in traditional banking and financial transactions, principally with non-residents of Puerto Rico. Furthermore, the scope of Eligible IFE Activities encompasses a wider variety of transactions than those previously authorized to IBEs.

Act 187, as amended, enacted on November 17, 2015, requires the Commissioner to issue a Certificate of Compliance every two years in order to certify the compliance with law of companies organized under IBE Act 52.

As of the date of the issuance of this Annual Report on Form 10-K, FirstBank IBE and FirstBank Overseas Corporation are operating under IBE Act 52.

Puerto Rico Income Taxes

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the “2011 PR Code”), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is generally not entitled to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a NOL, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry-forward period. The 2011 PR Code allows entities organized as limited liability companies to perform an election to become a non-taxable “pass-through” entity and utilize losses to offset income from other “pass-through” entities, subject to certain limitations, with the remaining net income passing-through to its partner entities. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from “controlled” subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

On December 10, 2018, the Governor of Puerto Rico signed into Law Act 257 to amend some of the provisions of the of 2011PR Code, as amended. Act 257 introduces various changes to the current income tax regime in the case of individuals and corporations, and the sales and use taxes that are effective January 1, 2019. See “Significant Events Since the Beginning of 2018 – Puerto Rico Government Fiscal Situation, Government Actions and Exposure to Puerto Rico Government” discussion above for additional details about changes introduced by the Act 257.

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

United States Income Taxes

The Corporation is also subject to federal income tax on its income from sources within the United States and on any item of income that is, or is considered to be, effectively connected with the active conduct of a trade or business within the United States. The U.S. Internal Revenue Code provides for tax exemption of any portfolio interest received by a foreign corporation from sources within the United States; therefore, the Corporation is not subject to federal income tax on certain U.S. investments that qualify under the term “portfolio interest.”

On December 22, 2017, the United States president signed H.R.1, The Tax Cuts and Jobs Acts, effective January 1, 2018, which includes an overhaul of individual, business and international taxes and has affected our branch operations in the U.S. and the USVI. The bill includes measures reducing corporate taxes from 35% to 21%, repealing the corporate alternative minimum tax regime, changing business deductions and NOLs, and imposing a 15.5% tax on mandatory repatriation of liquid assets, a 10% tax on base erosion payments, and a minimum 10.5% tax on inclusion of global intangible low-tax income by U.S. shareholders, among other significant changes. The main provisions affecting our operations in the U.S. and the USVI include: the change in tax rate to 21%, the limitation to the amount certain financial institutions, including the Bank, may deduct for premiums paid to the FDIC, and changes in permanent differences, such as meals and entertainment deductions. Other significant provisions, such as the base erosion and anti-abuse tax, do not affect the Corporation’s U.S. and USVI branch operations since these operations’ receipts do not exceed the annual threshold of U.S. effectively connected gross receipts.

Insurance Operations Regulation

FirstBank Insurance Agency is registered as an insurance agency with the Insurance Commissioner of Puerto Rico and is subject to regulations issued by the Insurance Commissioner relating to, among other things, the licensing of employees and sales and solicitation and advertising practices, and by the Federal Reserve as to certain consumer protection provisions mandated by the GLB Act and its implementing regulations.

Mortgage Banking Operations

In addition to FDIC and CFPB regulation, FirstBank is subject to the rules and regulations of the FHA, VA, FNMA, FHLMC, GNMA, and HUD with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines that include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts, and, with respect to VA loans, fix maximum interest rates. Moreover, lenders such as FirstBank are required annually to submit audited financial statements to the FHA, VA, FNMA, FHLMC, GNMA and HUD and each regulatory entity has its own financial requirements. FirstBank’s affairs are also subject to supervision and examination by the FHA, VA, FNMA, FHLMC, GNMA and HUD at all times to assure compliance with applicable regulations, policies and procedures. Mortgage origination activities are subject to, among other requirements, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act, and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder that, among other things, prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. FirstBank is licensed by the Commissioner under the Puerto Rico Mortgage Banking Law, and, as such, is subject to regulation by the Commissioner, with respect to, among other things, licensing requirements and the establishment of maximum origination fees on certain types of mortgage loan products.

Section 5 of the Puerto Rico Mortgage Banking Law requires the prior approval of the Commissioner for the acquisition of control of any mortgage banking institution licensed under such law. For purposes of the Puerto Rico Mortgage Banking Law, the term “control” means the power to direct or influence decisively, directly or indirectly, the management or policies of a mortgage banking institution. The Puerto Rico Mortgage Banking Law provides that a transaction that results in the holding of less than 10% of the outstanding voting securities of a mortgage banking institution shall not be considered a change in control.

Item 1A. Risk Factors

RISKS RELATING TO THE CORPORATION'S BUSINESS

The continuing effects of the September 2017 Hurricanes Maria and Irma may result in additional credit losses.

Two strong hurricanes (Maria and Irma) affected the Corporation's service areas during 2017 and caused significant damage to the infrastructure and property and severely disrupted normal economic activity in all of these regions. Significant overall uncertainties inherent in the Corporation's initial assessment of hurricane-related credit losses have largely been addressed in the year since the hurricanes. Commercial loan officers have continued to closely monitor the performance of hurricane-affected commercial loan customers during 2018. Information provided by these officers and statistics on the performance of consumer credits were factored into management's determination of the allowance for loan losses at December 31, 2018. Although the identification and evaluation of hurricane-affected credits has been completed, management's assessment of the hurricanes' effect is still subject to uncertainties, both those specific to certain individual customers, such as the resolution of insurance claims, and those applicable to the overall economic prospects of the hurricane-affected areas. Some of these uncertainties include how and when government, private or philanthropic funds will be invested in the affected communities, and how delays in foreclosure actions due to court-related backlogs may ultimately affect the values of the underlying real estate collateral of our residential mortgage portfolio. During 2018, the Corporation recorded a net loan loss reserve release of approximately $16.9 million in connection with revised estimates associated with the effects of the hurricanes. In addition, during 2018, consumer loan charge-offs totaling $10.9 million were taken against previously established hurricane-related qualitative reserves. With the future resolution of uncertainties and the ongoing collection of information on individual commercial customers and statistics on the consumer and residential loan portfolios, the loss estimate will be revised as needed. Any changes in the allowance calculation will be reflected in the provision for loan losses as they occur. As such, if this estimate proves to be incorrect, it may adversely affect our financial condition and results of operations.

The Corporation's force-placed insurance policies could be disputed by the customer.

The Corporation maintains force-placed insurance policies that have been put into place when a borrower's insurance policy on a property was cancelled, lapsed or was deemed insufficient and the borrower did not secure a replacement policy. A borrower may make a claim against the Corporation under such force-placed insurance policy and the failure of the Corporation to resolve such a claim to the borrower's satisfaction may result in a dispute between the borrower and the Corporation, which if not adequately resolved, could have an adverse effect on the Corporation.

Our level of non-performing assets may adversely affect our future results from operations.

We continue to have a high level of nonaccrual loans as of December 31, 2018, even though the level decreased by $165.8 million to $332.1 million as of December 31, 2018, or 33%, from $497.8 million as of December 31, 2017. Our nonaccrual loans represent approximately 4% of our $8.9 billion loan portfolio as of December 31, 2018. In addition, we have a high level of total non-performing assets, even though they decreased by $183.5 million to

$467.1 million as of December 31, 2018, or 28%, from $650.6 million as of December 31, 2017. Despite the overall decrease in non-performing asset levels for the entire year, during 2018, the Corporation designated as nonaccrual certain large commercial loans, including two commercial mortgage loans totaling $69.8 million related to a legacy commercial loan relationship that operates in both the Florida and Puerto Rico regions with independent sources of repayment. If we are unable to effectively maintain the quality of our loan portfolio, our financial condition and results of operations may be materially and adversely affected.

Certain funding sources may not be available to us and our funding sources may prove insufficient and/or costly to replace.

FirstBank relies primarily on customer deposits, the issuance of brokered CDs, and advances from the FHLB of New York to maintain its lending activities and to replace certain maturing liabilities. As of December 31, 2018, we had $555.6 million in brokered CDs outstanding, representing approximately 6% of our total deposits, and a reduction of $594.9 million from the year ended December 31, 2017. Approximately $259.6 million in brokered CDs mature over the next twelve months, and the average term to maturity of the retail brokered CDs outstanding as of December 31, 2018, was approximately 1.3 years. None of these CDs are callable at the Corporation's option.

Although FirstBank has historically been able to replace maturing deposits and advances, we may not be able to replace these funds in the future if our financial condition or general market conditions change. The use of brokered deposits has been particularly important for the funding of our operations. If we are unable to issue brokered deposits, or are unable to maintain access to other funding sources, our results of operations and liquidity would be adversely affected.

Alternate sources of funding may carry higher costs than sources currently utilized, particularly since the Federal Reserve has been increasing rates. If we are required to rely more heavily on more expensive funding sources, profitability would be adversely affected.

We may determine to seek debt financing in the future to achieve our long-term business objectives. Any future debt financing by the Corporation requires the prior approval of the Federal Reserve, and the Federal Reserve may not approve such financing. Additional borrowings, if sought, may not be available to us, or if available, may not be on acceptable terms. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit, our credit ratings and our credit capacity. In addition, the Bank may seek to sell loans as an additional source of liquidity. If additional financing sources are unavailable or are not available on acceptable terms, our profitability and future prospects could be adversely affected.

We depend on cash dividends from FirstBank to meet our cash obligations.

As a holding company, dividends from FirstBank have provided a substantial portion of our cash flow used to service the interest payments on our trust-preferred securities and other obligations. As stated above, we agreed to request approval from our regulators before receiving any cash dividends from FirstBank. In addition, FirstBank is limited by law in its ability to make dividend payments and other distributions to us based on its earnings and capital position. Our inability to receive approval from our regulators to receive dividends from FirstBank, or FirstBank's failure to generate sufficient cash flow to make dividend payments to us, may adversely affect our ability to meet all projected cash needs in the ordinary course of business and may have a detrimental impact on our financial condition.

If we do not obtain our regulators' approval to pay interest, principal or other sums on subordinated debentures or trust-preferred securities, a default may occur.

Following the termination of the Written Agreement, the Corporation agreed with the Federal Reserve to continue to obtain the approval of the Federal Reserve before paying dividends, receiving dividends from FirstBank, making any distributions of interest, principal or other sums on subordinated debentures or trust-preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock. Although the Corporation has received regulatory approvals that has enabled it to pay scheduled quarterly interest payments on the trust-preferred securities since the second quarter of 2016, it may not receive such approvals in the future. It is the intent of the Corporation to request approvals in future periods to continue to make regularly scheduled quarterly interest payments on the Corporation's outstanding subordinated debentures associated with its trust-preferred securities.

Under the subordinated debentures' indentures, we have the right, from time to time, and without causing an event of default, to defer payments of interest on the subordinated debentures by extending the interest payment period at any time and from time to time during the term of the subordinated debentures for up to twenty consecutive quarterly periods. We may need to elect extension periods for future quarterly interest payments if the Federal Reserve advises us that it will not approve such future quarterly interest payments or if we do not receive the approval from our regulators before receiving any cash dividends from FirstBank given that, as mentioned above, dividends from FirstBank have provided a substantial portion of our cash flow used to service the interest payments on our outstanding subordinated debentures. Our inability to receive approval from the Federal Reserve to make distributions of interest, principal or other sums on our trust-preferred securities and subordinated debentures or to receive cash dividends from FirstBank could result in a default under those obligations if we need to defer such payments for longer than twenty consecutive quarterly periods.

Credit quality may result in additional losses.

The quality of our loans has continued to be under pressure as a result of continued recessionary conditions in the markets we serve and the continuing effects of Hurricanes Irma and Maria that have led to, among other things, high unemployment levels, low 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 are adversely affected.

We have a commercial and construction loan portfolio held for investment in the amount of $3.8 billion as of December 31, 2018. Due to their nature, these loans entail a higher credit risk than consumer and residential mortgage loans, since they are larger in size, concentrate more risk in a single borrower and are generally more sensitive to economic downturns. Furthermore, given the slowdown in the real estate market, the properties securing these loans may be difficult to dispose of if they are foreclosed. During the first and third quarters 2018, the Corporation transferred $74.4 million in nonaccrual commercial and construction loans to held for sale. The aggregate recorded investment in these loans of $96.6 million was written down to $74.4 million, which resulted in charge-offs of $22.2 million, of which $6.5 million was taken against previously-established reserves for loan losses, resulting in a charge to the provision for loan and lease losses of $15.7 million in 2018. Approximately $57.2 million of the nonaccrual commercial and construction loans transferred to loans held for sale were eventually sold during the second, third and fourth quarters of 2018, resulting in an additional net loss of $2.7 million. We may incur additional losses over the near term, either because of continued deterioration of the quality of loans or because of additional sales of problem loans, which would likely accelerate the recognition of losses. Any such losses would adversely impact our overall financial performance and results of operations.

Our allowance for loan and lease losses may not be adequate to cover actual losses, and we may be required to materially increase our allowance, which may adversely affect our capital, financial condition and results of operations.

We are subject to the risk of loss from loan defaults and foreclosures with respect to the loans we originate and purchase. We establish a provision for loan and lease losses, which leads to reductions in our income from operations, in order to maintain our allowance for inherent incurred loan and lease losses at a level that our management deems to be appropriate based upon an assessment of the quality of the loan and lease portfolio. Management may fail to accurately estimate the level of inherent incurred loan and lease losses or may have to increase our provision for loan and lease losses in the future as a result of new information regarding existing loans, future increases in nonaccrual loans, foreclosure actions and loan modifications, changes in economic and other conditions affecting borrowers or for other reasons beyond our control. In addition, the bank regulatory agencies periodically review the adequacy of our allowance for loan and lease losses and may require an increase in the provision for loan and lease losses or the recognition of additional classified loans and loan charge-offs, based on judgments that are different from those of management.

The level of the allowance reflects management's estimates based upon various assumptions and judgments as to specific credit risks, its evaluation of industry concentrations, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan and lease losses inherently involves a high degree of subjectivity and requires management to make significant estimates and judgments regarding current credit risks and future trends, all of which may undergo material changes. If our estimates prove to be incorrect, our allowance for credit losses may not be sufficient to cover losses in our loan portfolio and our expense relating to the additional provision for credit losses could increase substantially.

Any such increases in our provision for loan and lease losses or any loan losses in excess of our provision for loan and lease losses would have an adverse effect on our future financial condition and results of operations. Given the difficulties facing some of our largest borrowers, these borrowers may fail to continue to repay their loans on a timely basis or we may not be able to assess accurately any risk of loss from the loans to these borrowers. See our risk factor "The continuing effects of the September 2017 Hurricanes Maria and Irma may result in additional credit losses" above for additional information about uncertainties surrounding the ultimate effect of the hurricanes on the affected regions.

Changes in collateral values of properties located in stagnant or distressed economies may require increased reserves.

Further deterioration of the value of real estate collateral securing our construction, commercial and residential mortgage loan portfolios would result in increased credit losses. As of December 31, 2018, approximately 1%, 17% and 36% of our loan portfolio held for investment consisted of construction, commercial mortgage and residential real estate loans, respectively.

Whether the collateral that underlies our loans is located in Puerto Rico, the USVI, the BVI, or the U.S. mainland, the performance of our loan portfolio and the collateral value backing the transactions are dependent upon the performance of and conditions within each specific real estate market. Puerto Rico, where most of the collateral is located, has been in an economic recession since 2006. Sustained weak economic conditions that have affected Puerto Rico over the last several years have resulted in declines in collateral values.

Construction and commercial loans, mostly secured by commercial and residential real estate properties, entail a higher credit risk than consumer and residential mortgage loans since they are larger in size, may have less collateral coverage, concentrate more risk in a single borrower and are generally more sensitive to economic downturns. As of December 31, 2018, our commercial mortgage and construction real estate loans held for investment in Puerto Rico amounted to $1.0 billion or 65% of the total $1.6 billion commercial mortgage and construction real estate loans, which constituted 18% of the total loan portfolio.

We measure the impairment of a loan based on the fair value of the collateral, if collateral dependent, which is generally obtained from appraisals. Updated appraisals are obtained when we determine that loans are impaired and are updated annually thereafter. In addition, appraisals are also obtained for certain residential mortgage loans on a spot basis based on specific characteristics such as delinquency levels, age of the appraisal and loan-to-value ratios. The appraised value of the collateral may decrease or we may not be able to recover collateral at its appraised value. A significant decline in collateral valuations for collateral dependent loans has required and, in the future, may require increases in our specific provision for loan losses and an increase in the general valuation allowance. Any such increase would have an adverse effect on our future financial condition and results of operations.

Interest rate shifts may reduce net interest income.

Shifts in short-term interest rates have reduced net interest income in the past and, in the future, may reduce net interest income, which is the principal component of our earnings. Net interest income is the difference between the amounts received by us on our interest-earning assets and the interest paid by us on our interest-bearing liabilities. Differences in the re-pricing structure of our assets and liabilities may result in changes in our profits when interest rates change. Net interest income in 2018 benefitted from the upward repricing of variable rate commercial and construction loans combined with an improved funding mix that was driven by the increase in the proportion of interest-earning assets funded by the growth in non-interest bearing deposits.

Increases in interest rates may reduce demand for mortgage and other loans.

Higher interest rates increase the cost of mortgage and other loans to consumers and businesses and may reduce future demand for such loans, which may negatively impact our profits by reducing the amount of loan interest income.

Accelerated prepayments may adversely affect net interest income.

In general, fixed-income portfolio yields would decrease if the re-investment of pre-payment amounts is at lower rates. Net interest income could also be affected by prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon the 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 accretion of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by our investment in callable securities because decreases in interest rates might prompt the early redemption of such securities.

Changes in interest rates on loans and borrowings may adversely affect net interest income.

Basis risk is the risk of adverse consequences resulting from unequal changes in the difference, also referred to as the “spread” or basis, between the rates for two or more different instruments with the same maturity and occurs when market rates for different financial instruments or the indices used to price assets and liabilities change at different times or by different amounts. For example, the interest expense for liability instruments such as brokered CDs might not change by the same amount as interest income received from loans or investments. To the extent that the interest rates on loans and borrowings change at different rates and by different amounts, the margin between our LIBOR-based assets and the higher cost of the brokered CDs might be compressed and adversely affect net interest income.

If all or a significant portion of the unrealized losses in our investment securities portfolio on our consolidated statement of financial condition is determined to be other-than-temporarily impaired, we would recognize a material charge to our earnings and our capital ratios would be adversely affected.

For the years ended December 31, 2016, 2017 and 2018, we recognized a total of $6.7 million, $12.2 million and $50 thousand, respectively, in other-than-temporary impairments. These impairments were primarily related to three Puerto Rico government debt securities that were sold during 2017. To the extent that any portion of the unrealized losses in our investment securities portfolio of $59.1 million as of December 31, 2018 is determined to be other-than-temporary and, in the case of debt securities, the loss is related to credit factors, we would recognize a charge to earnings in the quarter during which such determination is made and capital ratios could be adversely affected. Even if we do not determine that the unrealized losses associated with this portfolio require an impairment charge, increases in unrealized losses on available-for-sale securities adversely affect our tangible common equity ratio, which may adversely affect credit rating agency and investor sentiment towards us. Any negative perception also may adversely affect our ability to access the capital or credit markets or might increase our cost of capital. Valuation and other-than-temporary impairment determinations will continue to be affected by external market factors including default rates, severity rates and macro-economic factors.

Downgrades in our credit ratings could further increase the cost of borrowing funds.

The Corporation’s ability to access new non-deposit sources of funding, even if approved by the Federal Reserve, could be adversely affected by downgrades in our credit ratings. The Corporation’s liquidity is to a certain extent contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation’s current credit ratings and any downgrades in such credit ratings can hinder the Corporation’s access to new forms of external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations.

Defective and repurchased loans may harm our business and financial condition.

In connection with the sale and securitization of loans, we are required to make a variety of customary representations and warranties relating to the loans sold or securitized. Our obligations with respect to these representations and warranties are generally outstanding for the life of the loan, and relate to, among other things:

- compliance with laws and regulations;
- underwriting standards;
- the accuracy of information in the loan documents and loan files; and
- the characteristics and enforceability of the loan.

A loan that does not comply with these representations and warranties may take longer to sell, may impact our ability to obtain third-party financing for the loan, and may not be saleable or may be saleable only at a significant discount. If such a loan is sold before we detect non-compliance, we may be obligated to repurchase the loan and bear any associated loss directly, or we may be obligated to indemnify the purchaser against any loss, either of which could reduce our cash available for operations and liquidity. Management believes that it has established controls to ensure that loans are originated in accordance with the secondary market's requirements, but mistakes may be made, or certain employees may deliberately violate our lending policies.

We are subject to certain regulatory restrictions that may adversely affect our operations.

We are subject to supervision and regulation by the Federal Reserve Board and the FDIC. We are a bank holding company and a financial holding company under the Bank Holding Company Act of 1956, as amended. The Bank is also subject to supervision and regulation by the Puerto Rico Office of the Commissioner of Financial Institutions.

Under federal law, financial holding companies are permitted to engage in a broader range of "financial" activities than those permitted to bank holding companies that are not financial holding companies. A financial holding company that ceases to meet certain standards is subject to a variety of restrictions, depending on the circumstances, including the prohibition from undertaking new activities or acquiring shares or control of other companies. The Corporation currently is restricted in its ability to engage in new financial activities or the acquisition of shares or control of other companies without the prior written approval of the Federal Reserve Board.

On October 3, 2017, the Federal Reserve terminated the Written Agreement entered into on June 3, 2010 by the Corporation and the Federal Reserve. Although the Written Agreement is now terminated, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock. If we fail to comply with the requirements from our regulators, we may become subject to regulatory enforcement action and other adverse regulatory actions that might have a material and adverse effect on our operations.

Our controls and procedures may fail or be circumvented, our risk management policies and procedures may be inadequate and operational risks could adversely affect our consolidated results of operations.

We may fail to identify and manage risks related to a variety of aspects of our business, including, but not limited to, operational risk, interest-rate risk, trading risk, fiduciary risk, legal and compliance risk, liquidity risk and credit risk. We have adopted and periodically improved various controls, procedures, policies and systems to monitor and manage risk. Any improvements to our controls, procedures, policies and systems, however, may not be adequate to identify and manage the risks in our various businesses. If our risk framework is ineffective, either because it fails to keep pace with changes in the financial markets or our businesses or for other reasons, we could incur losses or suffer reputational damage or find ourselves out of compliance with applicable regulatory mandates or expectations.

We may also be subject to disruptions from external events that are wholly or partially beyond our control, which could cause delays or disruptions to operational functions, including information processing and financial market settlement functions. In addition, our customers, vendors and counterparties could suffer from such events. Should these events affect us, or the customers, vendors or counterparties with which we conduct business, our consolidated results of operations could be negatively affected. When we record balance sheet reserves for probable loss contingencies related to operational losses, we may be unable to accurately estimate our potential exposure, and any reserves we establish to cover operational losses may not be sufficient to cover our actual financial exposure, which may have a material impact on our consolidated results of operations or financial condition for the periods in which we recognize the losses.

Cyber-attacks, system risks and data protection breaches could present significant reputational, legal and regulatory costs.

Information security risks for financial institutions have significantly increased in recent years, especially as we continue to expand customer services via the internet and other remote service channels, and the sophistication and activities of organized crime, hackers, terrorists and other external parties have increased. These threats may derive from fraud or malice on the part of our employees or third-party providers, or may result from human error or accidental technological failure. These threats include cyber-attacks such as computer viruses, malicious code, phishing attacks or information security breaches and could lead to the misappropriation of consumer account and other information.

We have an Information Security Program which continuously monitors cyber-related risks and ultimately ensures protection for the processing, transmission and storage of confidential, proprietary and other information in our computer systems and networks. Furthermore, a formal vendor management program is in place to categorize and oversee third-party and vendor risks. The Corporation’s system of internal controls also incorporates an organization-wide protocol for the appropriate reporting and escalation of information security matters to management and the Corporation’s Board of Directors, to ensure effective and efficient resolution and, if necessary, disclosure of any matters. The Corporation’s Board of Directors is actively engaged in the oversight of the Corporation’s continuous efforts to reinforce and enhance its operational resilience.

To date, we have not experienced any material impact related to cyber-attacks or other information security breaches. However, future attacks or breaches could lead to security breaches of the networks, systems or devices that our customers use to access our integrated products and services, which in turn could result in the unauthorized disclosure, release, gathering, monitoring, misuse, loss or destruction of confidential, proprietary and other information (including account data information) or data security compromises. Such attacks or breaches could also cause service interruptions, malfunctions or other failures in the physical infrastructure or operations systems that support our businesses and customers (such as the lack of availability of our value-added services), as well as the operations of our customers or other third parties. In addition, they could lead to damage to our reputation with our customers and other parties and the market, additional costs to us (such as the costs of repairing systems, adding new personnel or protection technologies or compliance costs), regulatory penalties, financial losses to both us and our customers and partners and the loss of customers and business opportunities. If such attacks are not detected immediately, their effect could be compounded.

We rely on other companies to perform key aspects of our business infrastructure.

Third parties perform key aspects of our business operations such as data processing, information security, recording and monitoring transactions, online banking interfaces and services, internet connections and network access. While we believe that we have selected these third-party vendors carefully, we do not control their actions. Any significant problems caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher volumes, failure of a vendor to provide services for any reason, the provision by a vendor of poor performance of services, or failure of a vendor to notify us of a reportable event, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third-party vendor could also hurt our operations if those difficulties interfere with the vendor's ability to serve us. Replacing these third-party vendors could also create significant delay and expense. Accordingly, use of such third parties creates an inherent risk to our business operations.

Competition for our executives and other key employees is intense, and we may not be able to attract and retain the highly skilled people we need to support our business.

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities in which we engage can be intense, and we may not be able to hire people or retain them, particularly in light of uncertainty concerning compensation restrictions applicable to banks but not applicable to other financial services firms. The unexpected loss of services of one or more of our key personnel could adversely affect our business because of the loss of their skills, knowledge of our markets and years of industry experience and, in some cases, because of the difficulty of promptly finding qualified replacement employees. Similarly, the loss of our executives or other key employees, either individually or as a group, could result in a loss of customer confidence in our ability to execute banking transactions on their behalf.

Our compensation practices are subject to review and oversight by the Federal Reserve Board. We also may be subject to limitations on compensation practices by the FDIC or other regulators, which may or may not affect our competitors. Limitations on our compensation practices could have a negative impact on our ability to attract and retain talented senior leaders in support of our long term strategy.

Our compensation practices are subject to oversight by the Federal Reserve Board and the FDIC. Any deficiencies in our compensation practices may be incorporated into our supervisory ratings, which can affect our ability to make acquisitions or perform other actions. In addition, the regulation of our compensation practices may change in the future.

Our compensation practices are subject to oversight by the Federal Reserve Board and the FDIC. As discussed above, the Corporation currently is subject to the 2010 interagency guidance governing the incentive compensation activities of regulated banks and bank holding companies. Our failure to satisfy these restrictions and guidelines could expose us to adverse regulatory criticism, lowered supervisory ratings, and restrictions on our operations and acquisition activities. In addition, the federal banking agencies have proposed new regulations under the Dodd-Frank Act that place restrictions on the incentive compensation practices of banking organizations with $1 billion or more in assets.

The scope and content of the U.S. banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the ability of the Corporation and its subsidiaries to hire, retain and motivate their key employees.

Further increases in the FDIC deposit insurance premium or in FDIC required reserves may have a significant financial impact on us.

The FDIC insures deposits at FDIC-insured depository institutions up to certain limits (currently, $250,000 per depositor account). The FDIC charges insured depository institutions premiums to maintain the Deposit Insurance Fund (the "DIF"). In the event of a bank failure, the FDIC takes control of a failed bank and, if necessary, pays all insured deposits up to the statutory deposit insurance limits using the resources of the DIF. The FDIC is required by law to maintain adequate funding of the DIF, and the FDIC may increase premium assessments to maintain such funding.

The Dodd-Frank Act requires the FDIC to increase the DIF's reserves against future losses, which will require institutions with assets greater than $10 billion, such as FirstBank, to bear an increased responsibility for funding the prescribed reserve to support the DIF. Among other things, the Dodd-Frank Act requires the FDIC to bolster the DIF by increasing the required reserve ratio for the industry to 1.35 percent (the ratio of reserves to insured deposits) by September 30, 2020.

The FDIC's revised rule on deposit insurance assessments implements a provision in the Dodd-Frank Act that changes the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average Tier 1 capital. The rule changes the assessment rate schedules for insured depository institutions so that approximately the same amount of revenue would be collected under the new assessment base as would be collected under the previous rate schedule and the schedules previously proposed by the FDIC. The rule also revises the risk-based assessment system for all large insured depository institutions (generally, institutions with at least $10 billion in total assets, such as FirstBank). Under the rule, the FDIC uses a scorecard method to calculate assessment rates for all such institutions.

On September 30, 2018, the Deposit Insurance Fund Reserve Ratio reached 1.36 percent, exceeding the statutorily required minimum reserve ratio of 1.35 percent ahead of the September 30, 2020 deadline required under the Dodd-Frank Act. FDIC regulations provide for two changes to deposit insurance assessments upon reaching the minimum: (1) surcharges on insured depository institutions with total consolidated assets of $10 billion or more, such as FirstBank, will cease; and (2) small banks will receive assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from between 1.15 percent and 1.35 percent, to be applied when the reserve ratio is at or above 1.38 percent.

The FDIC may further increase FirstBank's premiums or impose additional assessments or prepayment requirements in the future. The Dodd-Frank Act removed the statutory cap for the reserve ratio, leaving the FDIC free to set this cap going forward.

Our businesses may be adversely affected by litigation.

From time to time, our customers, or the government on their behalf, makes claims and take legal action relating to our performance of fiduciary or contractual responsibilities. We have also faced employment lawsuits and other legal claims. In any such future claims or actions, demands for substantial monetary damages may be asserted against us, resulting in financial liability or an adverse effect on our reputation among investors or on customer demand for our products and services. We may be unable to accurately estimate our exposure to litigation risk when we record balance sheet reserves for probable loss contingencies. As a result, reserves we establish to cover any settlements or judgements may not be sufficient to cover our actual financial exposure, which has occurred in the past and may again occur, resulting in a material adverse impact on our consolidated results of operations or financial condition.

In the ordinary course of our business, we are also subject to various regulatory, governmental and law enforcement inquiries, investigations and subpoenas. These may be directed generally to participants in the businesses in which we are involved or may be specifically directed at us. In regulatory enforcement matters, claims for disgorgement, the imposition of penalties and the imposition of other remedial sanctions are possible.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. A securities class action suit against us could result in substantial costs, potential liabilities and the diversion of management's attention and resources.

The resolution of legal actions or regulatory matters, when unfavorable, has had and could in the future have a material adverse effect on our consolidated results of operations for the quarter in which such actions or matters are resolved or a reserve is established.

Our businesses may be negatively affected by adverse publicity or other reputational harm.

Our relationships with many of our customers are predicated upon our reputation as a fiduciary and a service provider that adheres to the highest standards of ethics, service quality and regulatory compliance. Adverse publicity, regulatory actions, litigation, operational failures, the failure to meet customer expectations and other issues with respect to one or more of our businesses could materially and adversely affect our reputation, or our ability to attract and retain customers or obtain sources of funding for the same or other businesses. Preserving and enhancing our reputation also depends on maintaining systems and procedures that address known risks and regulatory requirements, as well as our ability to identify and mitigate additional risks that arise due to changes in our businesses, the market places in which we operate, the regulatory environment and customer expectations. If we fail to promptly address matters that bear on our reputation, our reputation may be materially adversely affected and our business may suffer.

Changes in accounting standards issued by the Financial Accounting Standards Board may adversely affect our financial statements.

Our financial statements are subject to the application of U.S. Generally Accepted Accounting Principles ("GAAP"), which are periodically revised and expanded. Accordingly, from time to time, we are required to adopt new or revised accounting standards issued by the Financial Accounting Standards Board ("FASB"). The FASB has issued several financial accounting and reporting standards that will govern key aspects of the Corporation's financial statements or interpretations thereof when those standards become effective, including those areas where the Corporation is required to make assumptions or estimates. For example, the FASB's new accounting standard on credit losses, which will become effective for the Corporation on January 1, 2020, will require earlier recognition of credit losses on financial assets. The new accounting model requires that lifetime "expected credit losses" of financial assets not recorded at fair value through net income, such as loans and held-to-maturity securities, be recorded at inception of the financial asset, replacing the multiple existing impairment models under GAAP which generally require that a loss be "incurred" before it is recognized. Accordingly, the new accounting model presents operational challenges and will require the Corporation to change how it makes assumptions and estimates on loan and lease losses as well as other financial assets. For additional information on this and other accounting standards, see Note 1, "Nature of Business and Summary of Significant Accounting Policies" to the consolidated financial statements included in Item 8 of this Form 10-K.

Other changes to financial accounting or reporting standards or interpretations, whether promulgated or required by the FASB or other regulators, could also present operational challenges and could require the Corporation to change certain of the assumptions or estimates it previously used in preparing its financial statements, which could negatively impact how it records and reports its financial condition and results of operations generally and/or with respect to particular businesses. For additional information on the key areas for which assumption and estimates are used in preparing the Corporation's financial statements, see Note 1, "Nature of Business and Summary of Significant Accounting Policies" of the consolidated financial statements included in Item 8 of this Form 10-K.

Any impairment of our goodwill or amortizable intangible assets may adversely affect our operating results.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. Under GAAP, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Goodwill is tested for impairment at least annually. Factors that may be considered a change in circumstances, indicating that the carrying value of the goodwill or amortizable intangible assets may not be recoverable, include reduced future cash flow estimates and slower growth rates in the industry.

The goodwill impairment evaluation process requires us to make estimates and assumptions with regards to the fair value of our reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact our results of operations and the reporting unit to which the goodwill relates. We conducted our most recent evaluation of goodwill during the fourth quarter of 2018.

If we are required to record a charge to earnings in our consolidated financial statements because we identify an impairment of goodwill or amortizable intangible assets, our results of operations could be adversely affected.

Recognition of deferred tax assets is dependent upon the generation of future taxable income by the Bank.

As of December 31, 2018, the Corporation had a deferred tax asset of $319.9 million (net of a valuation allowance of $100.7 million, including a valuation allowance of $68.1 million against the deferred tax assets of the Corporation's banking subsidiary FirstBank). Under Puerto Rico law, the Corporation and its subsidiaries, including FirstBank, are treated as separate taxable entities and are not entitled to file consolidated tax returns. Accordingly, to obtain a tax benefit from NOLs, a particular subsidiary must be able to demonstrate sufficient taxable income. Nonetheless, the 2011 PR Code allows entities organized as limited liability companies to perform an election to become a non-taxable "pass-through" entity and utilize losses to offset income from other "pass-through" entities, subject to certain limitations, with the remaining net income passing-through to its partner entities. To obtain the full benefit of the applicable deferred tax asset attributable to NOLs, FirstBank and its pass-through entities must have sufficient taxable income within the applicable carry forward period. Pursuant to the 2011 PR Code, the carryforward period for NOLs incurred during taxable years that commenced after December 31, 2004 and ended before January 1, 2013 is 12 years; for NOLs incurred during taxable years commencing after December 31, 2012 the carryover period is 10 years. Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on an assessment of the amount of the deferred tax asset that is more likely than not to be realized.

Although the Corporation recognized a partial reverse of its valuation allowance related to its deferred tax assets based on a conclusion that, as of December 31, 2018, it is more likely than not that FirstBank will generate sufficient taxable income withn the applicable NOL carry-forward periods to realize a significant portion of its deferred tax assets, thereby reducing the Corporation's valuation allowance to $100.7 million as of December 31, 2018 from $191.2 million as of December 31, 2017, due to significant estimates utilized in determining the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that, in the future, the Corporation will not be able to reverse the remaining valuation allowance or that the Corporation will need to increase its current deferred tax asset valuation allowance.

The Corporation's judgments regarding tax accounting policies and the resolution of tax disputes may impact the Corporation's earnings and cash flow.

Significant judgment is required in determining the Corporation's effective tax rate and in evaluating its tax positions. The Corporation provides for uncertain tax positions when such tax positions do not meet the recognition thresholds or measurement criteria prescribed by applicable GAAP.

Fluctuations in federal, state, local and foreign taxes or a change to uncertain tax positions, including related interest and penalties, may impact the Corporation's effective tax rate. When particular tax matters arise, a number of years may elapse before such matters are audited and finally resolved. In addition, tax positions may be challenged by the Puerto Rico Department of Treasury ("PRTD"), the United States Internal Revenue Service ("IRS") and the tax authorities in the jurisdictions in which we operate and we may estimate and provide for potential liabilities that may arise out of tax audits to the extent that uncertain tax positions fail to meet the recognition standard under applicable GAAP. Unfavorable resolution of any tax matter could increase the effective tax rate and could result in a material increase in our tax expense. Resolution of a tax issue may require the use of cash in the year of resolution.

Changes in the Tax Law in multiple jurisdictions can materially affect our operations, tax obligations and effective tax rate.

First BanCorp. is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, it is treated as a foreign corporation for U.S. and USVI income tax purposes and is generally subject to U.S. and USVI income tax only on its income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those regions. The USVI jurisdiction imposes income taxes based on the U.S. Internal Revenue Code under the "mirror system" established by the Naval Service Appropriations Act of 1922. However, the USVI jurisdiction also imposes an additional 10% surtax on the USVI tax liability, if any.

These tax laws are complex and subject to different interpretations. We must make judgments and interpretations about the application of these inherently complex tax laws when determining our provision for income taxes, our deferred tax assets and liabilities, and our valuation allowance. In addition, legislative changes, particularly changes in tax laws, could adversely impact our results of operations.

On December 22, 2017, the United States president signed H.R.1, approved by Congress, including an overhaul of individual, business and international taxes, which impacts corporations doing business in the U.S. and the USVI (the "US Tax Reform"), but not in Puerto Rico. The US Tax Reform requires new computations to be performed that were not previously required in U.S. tax law and judgment is required in the interpretation of the provisions of the US Tax Reform. Some international provisions of the US Tax Reform, such as the GILTI tax, could also result in the relocation of U.S. Controlled Foreign Corporations ("CFC") doing business in Puerto Rico, which could have a significant impact on the economy of Puerto Rico and consequently on the operations of the Corporation. Also, the US Tax Reform could trigger changes in tax law or increase taxes in the USVI jurisdiction in order to offset the effects of the reduction in income tax rate in the USVI.

On December 10, 2018, the Governor of Puerto Rico signed into Law the Act 257 to amend some of the provisions of the 2011PR Code, as amended. Act 257 introduces various changes to the current income tax regime in the case of individuals and corporations, and the sales and use taxes that were effective January 1, 2019, including, among others, (i) a reduction in the Puerto Rico corporate tax rate from 39% to 37.5%; (ii) an increase in the net operating and capital losses usage limitation from 80% to 90%; (iii) amendments to the provisions related to "pass-through" entities that provide that corporations that own 50% or more of a partnership will not be able to claim a current or carryover non partnership NOL deduction against a partnership distributable share; and (iv) other limitations on certain deductions, such as meals and entertainment deductions. In the fourth quarter of 2018, the Corporation recorded a one-time charge of $9.9 million related to the remeasurement of deferred tax assets resulting from the aforementioned reduction in the corporate tax rates (net of the $5.6 million related impact in the valuation allowance).

Changes in Puerto Rico, the U.S. or other jurisdiction's applicable tax laws or tax authorities' new interpretations, could result in increases in our overall taxes and the Corporation's financial condition or results of operations may be adversely impacted.

Our ability to use our net operating loss (NOL) carryforwards may be limited.

The Corporation has Puerto Rico, U.S. and USVI sourced NOLs carryforwards. Section 382 of the U.S. Internal Revenue Code ("Section 382") and Section 1034.04(u) of the 2011 PR Code ("Section 1034.04(u)"), which is significantly similar to Section 382, limit the ability to utilize U.S., USVI and Puerto Rico NOLs, respectively, at such jurisdictions following an event of an ownership change. Generally, an ownership change occurs when certain shareholders increase their aggregate ownership by more than 50 percentage points over their lowest ownership percentage over a three-year testing period. However, Puerto Rico Section 1034.04(u) has an exemption ("the Capital Raise Exemption"), which allows a change in control to be exempt from Section 1034.04(u) if the purpose of the issuance is to raise capital for the operations of the entity, and immediately after the issuance, and for no less than five years, the entity's shares are marketed in one or more recognized stock exchanges. Upon the occurrence of a Section 382 or Section 1034.04(u) ownership change, the use of NOLs attributable to the period prior to the ownership change is subject to limitations and only a portion of the U.S., USVI and Puerto Rico NOLs, as applicable, may be used by the Corporation to offset the annual U.S., USVI and Puerto Rico taxable income, if any. During 2017, the Corporation completed a formal ownership change analysis within the meaning of Section 382 covering a comprehensive period, and concluded that an ownership change, for U.S. and USVI purposes only, occurred during the period evaluated. The Section 382 limitation resulted in higher U.S. liabilities than we would have incurred in the absence of such limitation.

Furthermore, it is possible that the utilization of our Puerto Rico, U.S. and USVI NOLs could be further limited due to future changes in our stock ownership, as a result of either sales of our outstanding shares or issuances of new shares that could separately or cumulatively trigger an ownership change and, consequently, a Section 1034.04(u) or Section 382 limitation. Any Section 1034.04(u) limitation for Puerto Rico resulting from any such future stock ownership changes could result in material adjustments to our deferred tax assets, earnings and cash flows. Any further Section 382 limitations may result in greater U.S. and USVI tax liabilities than we would incur in the absence of such a limitation and any increased liabilities could adversely affect our earnings and cash flow. We may be able to mitigate the adverse effects associated with a Section 382 limitation in the U.S. and USVI to the extent that we could credit any resulting additional U.S. and USVI tax liability against our tax liability in Puerto Rico. However, our ability to credit U.S. and USVI taxes against Puerto Rico taxes is subject to limitations and will depend on our tax profile and other factors at each annual taxable period.

We must respond to rapid technological changes, and these changes may be more difficult or expensive than anticipated.

If competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, our existing product and service offerings, technology and systems may become obsolete. Furthermore, if we fail to adopt or develop new technologies or to adapt our products and services to emerging industry standards, we may lose current and future customers, which could have a material adverse effect on our business, financial condition and results of operations. The financial services industry is changing rapidly and, in order to remain competitive, we must continue to enhance and improve the functionality and features of our products, services and technologies. These changes may be more difficult or expensive than we anticipate.

RISKS RELATING TO THE BUSINESS ENVIRONMENT AND OUR INDUSTRY

Continuation of the economic slowdown and decline in the real estate market in Puerto Rico could continue to harm our results of operations.

The residential mortgage loan origination business has historically been cyclical, enjoying periods of strong growth and profitability followed by periods of shrinking volumes and industry-wide losses. The market for residential mortgage loan originations has declined over the past few years and this trend may continue to reduce the level of mortgage loans we produce in the future and adversely affect our business. During periods of rising interest rates, the refinancing of many mortgage products tends to decrease as the economic incentives for borrowers to refinance their existing mortgage loans are reduced. In addition, the residential mortgage loan origination business is impacted by home values.

The actual rates of delinquencies, foreclosures and losses on loans have been higher during the economic slowdown in the United States in the late 2000s and early 2010s and in Puerto Rico since 2006. Rising unemployment, volatile interest rates and declines in housing prices have had a negative effect on the ability of borrowers to repay their mortgage loans. Any sustained period of increased delinquencies, foreclosures or losses could continue to adversely affect our ability to sell loans, the prices we receive for loans, the values of mortgage loans held for sale or residual interests in securitizations, which could continue to adversely affect our financial condition and results of operations. In addition, any additional material decline in real estate values would further weaken the loan-to-value ratios and increase the possibility of loss if a borrower defaults. In such event, we will be subject to the risk of loss on such real estate arising from borrower defaults to the extent not covered by third-party credit enhancement.

The Corporation's credit quality and the value of our portfolio of Puerto Rico government securities has been and in the future may be adversely affected by Puerto Rico's economic condition, and may be affected by actions taken by the Puerto Rico government or the PROMESA oversight board to address the ongoing fiscal and economic challenges in Puerto Rico.

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, which has been in an economic recession since 2006 that has been exacerbated by the effects of Hurricanes Irma and Maria in 2017. The New Fiscal Plan approved by the PROMESA oversight board, projects a contraction in Puerto Rico's gross national product of 8.0% for fiscal year 2018, followed by projected growths of 7.9% and 5.5% for fiscal years 2019 and 2020, respectively. Such projected growth was based on an assumption that over $82 billion of disaster relief funding will enter the economy of Puerto Rico from federal and private sources. Of the total disaster relief funding of $82 billion, estimated amounts of approximately $66 billion are to be used for public assistance, $3 billion for individual assistance, $8 billion for private and business insurance pay outs, and $5 billion is related to other federal funding. On July 30, 2018, HUD approved a $1.5 billion disaster recovery plan submitted by the Puerto Rico government that primarily focuses on the restoration of damaged and destroyed homes, businesses and infrastructure. The disaster recovery action plan includes the following activities: (i) housing ($1 billion) – for rebuilding and repairs of damaged properties, rental assistance, and appliances; (ii) economic revitalization ($145 million) – for eligible businesses to help-revitalize the post-disaster economy, including through grants; and (iii) infrastructure ($100 million) – for repairs of the damaged infrastructure in Puerto Rico. In February 2019, the Puerto Rico governor announced that HUD authorized the disbursement and use of funds approved through the aforementioned disaster recovery plan.

The EDB-EAI in November 2018 was 120.3, close to pre-hurricane levels of 122.1 in August 2017, and a 21.5% growth compared to post-hurricane levels of 99.0 in November 2017, mainly related to interruption of the electric energy system in 2017 due to hurricanes Irma and Maria. The EDB-EAI is a coincident index of economic activity for Puerto Rico made up of four indicators (non-farm payroll employment, electric power generation, cement sales and gasoline consumption). The cement sales for November 2018 totaled 1.2 million of 94-pound bags, an increase of 6.3% over the prior month, and an annual increase of 64.3%. Estimated gasoline consumption in November 2018 was 78.1 million gallons, a 2.8% decrease when compared with October 2018, and a decrease of 6.7% compared to the same period in 2017. Electric power generation for November 2018 totaled 1,532.5 million kilowatt-hours, an increase of 3.3% over the prior month, and an annual increase of 94.7% compared with the same period in 2017. The revised version of the New Fiscal Plan projects that the hurricanes will create a spike in inflation of 1.6% in fiscal year 2018, with subsequent average increases of about 1.49% over the next six years, until fiscal year 2023. The seasonally adjusted unemployment rate in Puerto Rico was 8.3% in December 2018, compared to 11.0% in December 2017. The Puerto Rico labor force participation rate was 40.8% as of December 2018. The average of the labor force participation rate in Puerto Rico was 45.05% from 1990 until 2017, reaching an all-time high of 49.80% in February of 2007 and a record low of 38.6% in October of 2017. Based on information published by the Puerto Rico government, the labor force estimate was 1.1 million people as of December 2018, a reduction of 1.4% when compared with December 2017.

The New Fiscal Plan reflects a 5.5% decline in population by fiscal year 2023. In addition, the revised New Fiscal Plan established an annual emergency reserve of $130 million for 10 years. As mentioned above, it also assumes $82 billion in disaster relief funding and projects that a $30 billion surplus will be generated through fiscal year 2033. The

New Fiscal Plan includes a series of structural reforms in areas, such as: (i) human capital and labor; (ii) ease of doing business; (iii) power sector reform; and (iv) infrastructure reform. The New Fiscal Plan also proposes fiscal measures projected to drive $12.4 billion in increased revenues and reduced expenditures through fiscal year 2023 and projects that structural reforms will drive a cumulative 1.21% increase in growth by Fiscal year 2058.

Based on information published by the Puerto Rico Treasury, the net revenues of the Puerto Rico government's General Fund in November 2018 totaled $556.9 million, which was $16.8 million less than in November 2017, and $25.5 million over projections in the New Fiscal Plan. The net revenue to the General Fund for the first five months of the fiscal year ending June 30, 2019 totaled $3,540.2 million, an increase of $611.8 million, compared with the same period of the previous fiscal year.

On February 4, 2019, the U.S. District Judge Laura Taylor Swain, approved the COFINA plan, a restructuring agreement for bondholders of debt issued by the Puerto Rico Sales Tax Financing Corporation ("COFINA," by its Spanish acronym). The COFINA plan restructures $18.0 billion of COFINA debt, which represents 24% of Puerto Rico's funded debt. In addition, the COFINA plan, reduced the annual cash flow to COFINA from a maximum of $1.8 billion to $992 million and provides to the Government of Puerto Rico an average annual savings of $425 million for the next 40 years.

As of December 31, 2018, the Corporation had $214.6 million of direct exposure to the Puerto Rico government, its municipalities and public corporations, compared to $214.5 million as of December 31, 2017. As of December 31, 2018, approximately $191.9 million of the exposure consisted of loans and obligations of municipalities in Puerto Rico that are supported by assigned property tax revenues and for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment, compared to $184.6 million as of December 31, 2017. Approximately 75% of the Corporation's municipality exposure consisted primarily of senior priority obligations concentrated in three of the largest municipalities in Puerto Rico. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. The PROMESA oversight board has not designated any of the Commonwealth's 78 municipalities as covered entities under PROMESA. However, while the New Fiscal Plan certified by the PROMESA oversight board did not contemplate a restructuring of the debt of Puerto Rico's municipalities, the plan did call for the gradual elimination of budgetary subsidies provided to municipalities. Furthermore, municipalities are also likely to be affected by the negative economic and other effects resulting from expense, revenue or cash management measures taken to address the Puerto Rico government's fiscal and liquidity shortfalls, as well as measures included in fiscal plans of other government entities. In addition to municipalities, the total direct exposure also included a $14.5 million loan to an affiliate of PREPA and obligations of the Puerto Rico government, specifically bonds of the Puerto Rico Housing Finance Authority, at an amortized cost of $8.2 million as part of its available-for-sale investment securities portfolio (fair value of $7.0 million as of December 31, 2018).

In addition, as of December 31, 2018, the Corporation had $112.1 million in exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to $75 million of the principal under the mortgage loan insurance program. According to the most recently-released audited financial statements of the Puerto Rico Housing Finance Authority, as of June 30, 2016, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans in an aggregate of approximately $576 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loan insurance fund. As of June 30, 2016, the most recent date as to which information is available, the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately $77.4 million.

As of December 31, 2018, the Corporation had $677.3 million of public sector deposits in Puerto Rico, compared to $490.3 million as of December 31, 2017. Approximately 34% is from municipalities and municipal agencies in Puerto Rico and 66% is from public corporations and the central government and agencies in Puerto Rico.

Future deterioration in economic activity and the potential impact on asset values resulting from the hurricanes, when added to Puerto Rico's ongoing fiscal crisis and recession, could materially adversely affect our business, financial condition, liquidity, results of operations and capital position.

Continuation of the economic slowdown and decline in the U.S. Virgin Islands could continue to harm our results of operations.

The fiscal health of the government of the USVI over the past 10 years has shown signs of deterioration evidenced by persistent budgetary deficits and projected future revenue shortfalls. In September 15, 2016, the government of the USVI developed a five-year financial plan, designed to return the general fund to fiscal stability. The fiscal stabilization plan included a number of revenue enhancement initiatives as well as reductions to government operating expenses. Many of the USVI government’s revenue enhancement initiatives are subject to legislative approval and are in the form of tax increases that could potentially have an adverse effect on the economy. The fiscal stabilization plan is also predicated on access of the government to the financial markets in order to issue deficit financing to cover the operating deficits incurred in 2017 and 2018.

The passage of hurricanes Irma and Maria through the region caused significant damage to the USVI’s core infrastructure, including housing, electricity and the government’s ability to provide certain essential services. Since the hurricanes, most schools have reopened, energy and water consumers have service, street light fixtures have been repaired or replaced, and tourism has been recovering. Considering the aforementioned challenges, the government has decided to amend the five-year financial plan in order to create new revenues, reduce public spending, and create a fair salary payment system for public employees. Further declines in the economic activity of this region could result in further adverse effects on our profitability and credit quality.

To the extent that the fiscal condition of the USVI government continues to deteriorate, the U.S. Congress or the government of the USVI may enact legislation allowing for the restructuring of the financial obligations of the USVI government entities or imposing a stay on creditor remedies, including by making PROMESA applicable to the USVI.

As of December 31, 2018, the Corporation had total exposure to the USVI government and its instrumentalities of $55.8 million, approximately $32.6 million was owed by public corporations of the USVI and $23.2 million was owed by an independent instrumentality of the USVI government. All loans are currently performing and up to date on principal and interest payments.

Difficult market conditions have affected the financial industry and may adversely affect us in the future.

Given that most of our business is in Puerto Rico and the United States and given the degree of interrelation between Puerto Rico’s economy and that of the United States, we are exposed to downturns in the U.S. economy, including factors such as unemployment and underemployment levels in the United States and real estate valuations. The deterioration of these conditions adversely affected us in the past and, in the future, could adversely affect the credit performance of mortgage loans, credit default swaps and other derivatives, and result in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial banks and investment banks.

Despite improving labor markets in the U.S. in the past year, an elevated amount of underemployment and household debt, the volatile interest rate environment, along with a continued sluggish recovery in the consumer real estate market and certain commercial real estate markets in the U.S. pose challenges for the U.S. economic performance and the financial services industry.

In particular, we may face the following risks:

- Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage, and underwrite the loans become less predictive of future behaviors.

- The models used to estimate losses inherent in the credit exposure, particularly those under the new credit loss accounting model with which we must comply beginning in 2020, require difficult, subjective, and complex judgments, including forecasts of economic conditions and how these economic predictions might impair the ability of the borrowers to repay their loans, which may no longer be capable of accurate estimation and which may, in turn, impact the reliability of the models.

- Our ability to borrow from other financial institutions or to engage in sales of mortgage loans to third parties (including mortgage loan securitization transactions with government-sponsored entities and repurchase agreements) on favorable terms, or at all, could be adversely affected by further disruptions in the capital or credit markets or other events, including deteriorating investor expectations.

- Competitive dynamics in the industry could change as a result of consolidation of financial services companies in connection with current market conditions.

- Expected future regulation of our industry may increase our compliance costs and limit our ability to pursue business opportunities.

- There may be downward pressure on our stock price.

Any future deterioration of economic conditions in the U.S. and disruptions in the financial markets could adversely affect our ability to access capital, our business, financial condition and results of operations.

The failure of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by future failures of financial institutions and the actions and commercial soundness of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to different industries and counterparties and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, investment companies and other institutional clients. In certain of these transactions, we are required to post collateral to secure the obligations to the counterparties. In the event of a bankruptcy or insolvency proceeding involving one of such counterparties, we may experience delays in recovering the assets posted as collateral, or we may incur a loss to the extent that the counterparty was holding collateral in excess of the obligation to such counterparty or under other circumstances, such as the loss in 2013 of our assets that we pledged to Lehman Brothers, Inc.

In addition, many of these transactions expose us to credit risk in the event of a default by our counterparty or client. The credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to us. Any losses resulting from our routine funding transactions may materially and adversely affect our financial condition and results of operations.

Legislative and regulatory actions taken now or in the future may increase our costs and impact our business, governance structure, financial condition or results of operations.

We and our subsidiaries are subject to extensive regulation by multiple regulatory bodies. These regulations may affect the manner and terms of delivery of our services. If we do not comply with governmental regulations, we may be subject to fines, penalties, lawsuits or material restrictions on our businesses in the jurisdiction where the violation occurred, which may adversely affect our business operations. Changes in these regulations can significantly affect the services that we are asked to provide as well as our costs of compliance with such regulations. In addition, adverse publicity and damage to our reputation arising from the failure or perceived failure to comply with legal, regulatory or contractual requirements could adversely affect our ability to attract and retain customers.

The financial crisis of 2008 resulted in regulatory agencies and political bodies placing increased focus and scrutiny on the financial services industry. The U.S. government intervened on an unprecedented scale, responding by temporarily 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 financial institutions to additional restrictions, oversight and costs. In addition, new proposals for legislation are periodically introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry, 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 interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to residential real estate mortgages, among other things. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied.

Regulatory uncertainty caused by financial deregulation measures proposed by the Trump administration and members of the U.S. Congress may increase competition in certain of our investment strategies and adversely affect our business, financial condition and results of operations.

The Trump administration's short-term legislative agenda includes certain deregulatory measures for the U.S. financial services industry, including changes to the Volcker Rule, the U.S. Risk Retention Rules, the Basel III capital requirements, the U.S. Treasury's Financial Stability Oversight Council's (the "FSOC's") authority and other aspects of the Dodd-Frank Act. On February 3, 2017, President Trump signed an executive order calling for the administration to review U.S. financial laws and regulations in order to determine their consistency with a set of core principles identified in the order. Limited scope financial services legislation enacted into law in May 2018 made some changes to the Dodd-Frank Act and other banking laws that were deregulatory in nature, but overall did not have a material impact on banking organizations with the Corporation's business and risk profile.

The 116th Congress, with House of Representatives control passing to the Democratic party, has now been sworn in. In turn, whether additional financial services legislation will be enacted in the current session of Congress or signed by the president remains unclear. In the absence of legislative change, the Trump administration may seek to influence the substance of regulatory supervision through, among other things, the appointment of individuals to the Federal Reserve Board, the FDIC and the CFPB. The administration nominated, and the Senate confirmed, Jerome Powell as Chair of the Federal Reserve Board, and Randal Quarles as a Governor and new Vice Chairman for Supervision. Further, President Trump is expected to nominate persons to fill other of the Federal Reserve Board's seven seats. In turn, the appointment of new Federal Reserve Board members may increase the likelihood that the Federal Reserve Board will modify the capital and liquidity requirements for U.S. banking organizations to levels that are more stringent than those that have been agreed upon at the international level, including the Basel Committee on Banking Supervision's Basel III framework. The Trump administration nominated, and the Senate confirmed, Jelena McWilliams, a former Senate Banking Committee senior staff member and banking industry executive, as Chair of the FDIC.

In addition, the Trump administration nominated, and the Senate confirmed, Kathy Kraninger, a former senior official at the Office of Management and Budget, as the new permanent director of the CFPB. Mick Mulvaney, director of the Office of Management and Budget, who, prior to Ms. Kraninger's appointment, was acting Director of the CFPB, took actions as acting Director that were largely consistent with the announced deregulatory agenda of the Trump administration and Ms. Kraninger may elect to continue pursuing that agenda. The impact of these and other future actions on the CFPB's regulatory and enforcement activities as they affect FirstBank, however, cannot be predicted with any certainty at this time.

Measures focused on deregulation of the U.S. financial services industry may have the effect of increasing competition for our credit-focused businesses or otherwise reducing investment opportunities. Increased competition from banks and other financial institutions in the credit markets could have the effect of reducing credit spreads, which may adversely affect the revenues of our credit and other businesses, whose strategies include the provision of credit to borrowers.

Determining the full extent of the impact on us of any such potential financial reform legislation, or whether any such particular proposal will become law, or the impact of regulatory changes in the absence of legislation at this point in time is highly speculative. However, any such changes may impose additional costs on us, require the attention of our senior management or Board or result in limitations on the manner in which business is conducted.

Financial services legislation and regulatory reforms may have a significant impact on our business and results of operations and on our credit ratings.

As discussed above, the Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes, and the regulations developed and to be developed thereunder include or will include, provisions affecting large and small financial institutions alike. In addition, U.S. banking organizations, including the Corporation and FirstBank, are subject to new and more stringent regulatory capital requirements that generally increase the amounts of capital that we need to hold.

As of December 31, 2018, the Corporation had $178.6 million in trust-preferred securities that are now subject to the full phase-out from Tier 1 capital under the final regulatory capital rules discussed above.

Although First BanCorp. and FirstBank were able to meet general well-capitalized capital ratios upon implementation of the requirements, and we expect both companies will continue to exceed the minimum risk-based and leverage capital ratio requirements for well-capitalized status under the new capital rules, we may not remain at such levels.

Additional regulatory proposals and legislation, if finally adopted, could change banking laws and our operating environment and that of our subsidiaries in substantial and unpredictable ways. The ultimate effect that such legislation, if enacted, or regulations would have on our financial condition or results of operations may be adverse.

We are subject to regulatory capital adequacy guidelines, and, if we fail to meet these guidelines, our business and financial condition will be adversely affected.

Under regulatory capital adequacy guidelines, and other regulatory requirements, the Corporation and our banking subsidiary must meet guidelines that include quantitative measures of assets, liabilities and certain off balance sheet items, subject to qualitative judgments by regulators regarding components, risk weightings and other factors. If we fail to meet these minimum capital guidelines and other regulatory requirements, our business and financial condition will be materially and adversely affected. If we fail to maintain certain capital levels, or are deemed not well managed under regulatory exam procedures, or if we experience certain regulatory violations, our status as a financial holding company, and our ability to offer certain financial products will be compromised and our financial condition and results of operations could be adversely affected.

Monetary policies and regulations of the Federal Reserve Board could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve Board. An important function of the Federal Reserve Board is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve Board to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate and changes in reserve requirements for bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve Board have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations may be adverse.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The U.S. Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful regulatory challenge to an institution's performance under the Community Reinvestment Act or fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

We face a risk of noncompliance and enforcement action related to the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act, the USA PATRIOT Act, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The Financial Crimes Enforcement Network is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice's Drug Enforcement Administration. We are also subject to increased scrutiny of compliance with trade and economic sanctions requirements and rules enforced by OFAC. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition and results of operations.

RISKS RELATING TO AN INVESTMENT IN THE CORPORATION'S COMMON AND PREFERRED STOCK

Issuance of additional equity securities in the public markets and other capital management or business strategies that we may pursue could depress the market price of our common stock and could result in dilution of the interest of holders of our common stock.

Generally, we are not restricted from issuing additional equity securities, including common stock. We may choose to sell additional equity securities, or we could be required in the future to identify, consider and pursue additional capital management strategies to bolster our capital position. We may issue equity securities (including convertible securities, preferred securities, and options and warrants on our common or preferred stock securities) in the future for a number of reasons, including to finance our operations and business strategy, such as to make acquisitions, adjust our leverage ratio, address regulatory capital concerns, or restructure currently outstanding debt or equity securities. Future issuances of our equity securities, including common stock, in any transaction that we may pursue may dilute the interests of our existing holders of our common stock and preferred stock and cause the market price of our common stock to decline.

The market price of our common stock may continue to be subject to significant fluctuations and volatility.

The stock markets have frequently experienced high levels of volatility since 2008. These market fluctuations have adversely affected, and may continue to adversely affect, the trading price of our common stock. In addition, the market price of our common stock has been subject to significant fluctuations and volatility because of factors specifically related to our businesses and may continue to fluctuate or decline.

Factors that could cause fluctuations, volatility or a decline in the market price of our common stock, many of which could be beyond our control, include the following:

- uncertainties and developments related to the resolution of the Puerto Rico government's fiscal problems;
- any regulatory actions against us;
- changes or perceived changes in the condition, operations, results or prospects of our businesses and market assessments of these changes or perceived changes;
- announcements of strategic developments, acquisitions and other material events by us or our competitors, including any failures of banks;
- changes in governmental regulations or proposals, or new governmental regulations or proposals, affecting us;
- a continuing recession in the Puerto Rico market and a lack of growth in our other principal markets in the USVI, the BVI and the U.S.;
- the departure of key employees;
- changes in the credit, mortgage and real estate markets;
- operating results that vary from the expectations of management, securities analysts and investors;
- operating and stock price performance of companies that investors deem comparable to us; and
- the public perception of the banking industry and its safety and soundness.

In addition, the stock market in general, and the NYSE and the other trading markets for the securities of commercial banks and other financial services companies in particular, have experienced significant price and volume fluctuations that sometimes have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our operating performance or Puerto Rico's economic environment. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. A securities class action suit against us could result in substantial costs, potential liabilities and the diversion of management's attention and resources.

Our suspension of dividends may have adversely affected and may further adversely affect our stock price and could result in the expansion of our Board of Directors.

The Corporation's ability to declare and pay dividends is dependent on certain Federal regulatory considerations, including the guidelines of the Federal Reserve Board regarding capital adequacy and the approval of the Federal Reserve Board to declare or pay dividends and receive dividends from the Bank to fund any such dividend payments. The Corporation did not pay any dividends on its common stock between July 2009 and December 2018, after the Corporation's Board determined to suspend the payment of dividends on its common stock based on its assessment of the financial results for the quarter ended June 30, 2009 and applicable Federal Reserve Board guidance. On November 14, 2018, for the first time since July 2009, the Corporation's Board of Directors, after receiving regulatory approval, declared a quarterly cash dividend of $0.03 per common share that was paid on December 14, 2018 to common stockholders of record on November 30, 2018. Total cash dividends paid on shares of common stock amounted to $6.5 million for 2018. In addition, since the fourth quarter of 2016, following receipt of the requisite regulatory approval, the Corporation has paid monthly cash dividends on its outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock. The Corporation has to date received approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock and quarterly dividends on common stock through December 2019, subject to conditions established in the agreement with regulators. Thereafter, the Corporation intends to continue to request the Federal Reserve's approval to continue to pay the monthly dividends on its Series A through E Preferred Stock and quarterly dividends on its common stock.

If the Corporation does not pay dividends in full for eighteen monthly dividend periods (whether consecutive or not), the holders of the Series A through E Preferred Stock as to which dividends have not been paid for eighteen-months, acting as a single class, will be entitled to appoint two additional members to our Board of Directors. Any member of the Board of Directors appointed by the holders of Series A through E Preferred Stock is required to vacate his or her office if the Corporation resumes the payment of dividends in full for twelve consecutive monthly dividend periods.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of February 15, 2019, First BanCorp. owned the following three main offices located in Puerto Rico:

- Headquarters – Located at First Federal Building, 1519 Ponce de León Avenue, Santurce, Puerto Rico, a 16-story office building. Approximately 51% of the building, an underground three level parking garage and an adjacent parking lot are owned by the Corporation.

- Service Center – a building located on 1130 Muñoz Rivera Avenue, Hato Rey, Puerto Rico. These facilities accommodate branch operations, data processing and administrative and certain headquarter offices. The building houses 180,000 square feet of modern facilities, over 1,000 employees from operations, the FirstBank Insurance Agency headquarters and the customer service department. In addition, it has parking for 750 vehicles and 9 training rooms, including classrooms for training tellers and a computer room for interactive trainings, as well as a spacious cafeteria for employees and customers.

- Consumer Lending Center – A three-story building with a three-level parking garage located at 876 Muñoz Rivera Avenue, Hato Rey, Puerto Rico. This facility is fully occupied by the Corporation.

The Corporation owns 20 branch and office premises and parking lots and leases 79 branch premises, loan and office centers and other facilities. In certain situations, financial services such as mortgage and insurance businesses and commercial banking services are located in the same building. All of these premises are located in Puerto Rico, Florida and the USVI and the BVI. Management believes that the Corporation's properties are well maintained and are suitable for the Corporation's business as presently conducted.

Item 3. Legal Proceedings

Reference is made to Note 32, “Regulatory Matters, Commitments and Contingencies,” included in the Notes to consolidated financial statements in Item 8 of this Report, which is incorporated herein by reference.

Item 4. Mine Safety Disclosure.

Not applicable.

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities

Information about Market and Holders

The Corporation's common stock is traded on the NYSE under the symbol FBP. On February 15, 2019, there were 378 holders of record of the Corporation's common stock, not including beneficial owners whose shares are held in the name of brokers or other nominees. The last sales price for the common stock on that date was $11.15.

On November 14, 2018, for the first time since July 2009, the Corporation's Board of Directors, after receiving regulatory approval, declared a quarterly cash dividend of $0.03 per common share that was paid on December 14, 2018 to common stockholders of record at the close of business on November 30, 2018. The Corporation received approval to pay a common stock dividend through December 2019, subject to conditions established in the agreement with regulators. In addition, since December 2016, the Corporation has been making monthly dividend payments on the non-cumulative perpetual monthly income preferred stock which, along with common stock dividend payments, were suspended during the third quarter of 2009. The common stock ranks junior to all series of preferred stock as to dividend rights and as to rights on liquidation, dissolution or winding up of the Corporation.

On May 17, 2018, the U.S. Treasury exercised its warrant to purchase 1,285,899 shares of the Corporation's stock on a cashless basis resulting in the issuance of 730,571 shares of common stock and the use of 555,328 shares to cover the strike price of the transaction. Cash paid in lieu of fractional shares was $6.58.

On May 10, 2017, the U.S. Treasury announced that it sold all of its remaining 10,291,553 shares of the Corporation's common stock. Since the U.S. Treasury did not recover the full amount of its original investment under TARP, 2,370,571 outstanding restricted shares held by the Corporation's employees were forfeited, resulting in a reduction in the number of common shares outstanding.

On December 5, 2016, funds affiliated with Thomas H. Lee Partners, L.P. ("THL") and funds managed by Oaktree Capital Management, L.P. ("Oaktree") completed a secondary offering of the Corporation's common stock. THL and Oaktree sold an aggregate of 18 million shares (9 million shares each) of common stock at a price of $5.60 per share. In addition, the underwriters exercised their option to purchase an additional 2.7 million shares of common stock from the selling stockholders. Also, on February 7, 2017, THL and Oaktree participated in a second secondary offering in which they sold an additional aggregate amount of 20 million shares (10 million shares each) of common stock at a price of $6.36 per share. Subsequently, the underwriters exercised their option to purchase an additional 3 million shares of common stock from the selling stockholders. Furthermore, on August 3, 2017, THL and Oaktree participated in a third secondary offering of the Corporation's common stock in which they sold an aggregate of 20 million shares (10 million shares each) of common stock at a price of $5.70 per share. The Corporation did not receive any proceeds from these offering.

Based on information solely derived from statements filed with the SEC pursuant to Section 13(d), 13(g) or 16 (a) of the Exchange Act, as of December 31, 2018 each of THL and Oaktree owned less than 5% of the Corporation's outstanding common stock.

Effective April 1, 2013, the Corporation's Board of Directors determined to increase the salary amounts paid to certain executive officers, primarily by paying the increased salary amounts in the form of shares of the Corporation's common stock issued under the Omnibus Plan, instead of cash. During 2018, the Corporation issued 268,709 shares of common stock (as compared to 582,193 shares during 2017) with a weighted average market value of $6.51 (as compared to a weighted average market value of $5.64 during 2017) as salary stock compensation. The Corporation withheld 96,377 shares from the common stock paid to the officers as additional compensation to cover employee payroll and income tax withholding liabilities in 2018 (2017 – 195,789 shares); these shares are held as treasury shares. Effective July 1, 2018, the payment of additional salary amounts in the form of stock was eliminated in accordance with a revised executive compensation program.

In 2018, the Corporation granted 407,886 shares of restricted stock to certain executive officers, other employees, and independent directors (2017 – 1,099,756 shares). In connection with the vesting of restricted stock in 2018, the Corporation withheld 337,689 shares of restricted stock (2017 – 243,102 shares) to cover employee payroll and income tax withholding liabilities; these shares are also held as treasury shares.

As of December 31, 2018 and December 31, 2017, the Corporation had 4,554,369 and 4,104,303 shares held as treasury stock, respectively.

The Corporation has 50,000,000 authorized shares of preferred stock. First BanCorp. has five outstanding series of nonconvertible, noncumulative preferred stock: 7.125% noncumulative perpetual monthly income preferred stock, Series A (liquidation preference $25 per share); 8.35% noncumulative perpetual monthly income preferred stock, Series B (liquidation preference $25 per share); 7.40% noncumulative perpetual monthly income preferred stock, Series C (liquidation preference $25 per share); 7.25% noncumulative perpetual monthly income preferred stock, Series D (liquidation preference $25 per share); and 7.00% noncumulative perpetual monthly income preferred stock, Series E (liquidation preference $25 per share) (collectively, the "Series A through E Preferred Stock"). Effective January 17, 2012, the Corporation delisted all of its outstanding series of preferred stock from the NYSE. The Corporation has not arranged for listing on another national securities exchange or for quotation of the Series A through E Preferred Stock in a quotation medium.

The Series A through E Preferred Stock rank on a parity with respect to dividend rights and rights upon liquidation, winding up or dissolution. Holders of each series of preferred stock are entitled to receive cash dividends, when, as and if declared by the board of directors of First BanCorp. out of funds legally available for dividends.

The terms of the Corporation's Series A through E Preferred Stock do not permit the Corporation to declare, set apart or pay any dividend or make any other distribution of assets on, or redeem, purchase, set apart or otherwise acquire shares of common stock or of any other class of stock of First BanCorp. ranking junior to the preferred stock, unless all accrued and unpaid dividends on the preferred stock and any parity stock for the twelve monthly dividend periods ending on the immediately preceding dividend payment date shall have been paid or are paid contemporaneously; the full monthly dividend on the preferred stock and any parity stock for the then current month has been or is contemporaneously declared and paid or declared and set apart for payment; and the Corporation has not defaulted in the payment of the redemption price of any shares of the preferred stock and any parity stock called for redemption. If the Corporation is unable to pay in full the dividends on the preferred stock and on any other shares of stock of equal rank as to the payment of dividends, all dividends declared upon the preferred stock and any such other shares of stock will be declared pro rata.

The Corporation may not issue shares ranking, as to dividend rights or rights on liquidation, winding up and dissolution, senior to the Series A through E Preferred Stock, except with the consent of the holders of at least two-thirds of the outstanding aggregate liquidation preference of such preferred stock.

Dividends

The Corporation had a policy of paying quarterly cash dividends on its outstanding shares of common stock subject to its earnings and financial condition until June 2009. On November 14, 2018, for the first time since June 2009, the Corporation's Board of Directors, after receiving regulatory approval, declared a quarterly cash dividend of $0.03 per common share which was paid on December 14, 2018, to common stockholders of record at the close of business on November 30, 2018. The Corporation received approval to pay this dividend through December 2019, subject to conditions established in the agreement with regulators. In addition, for the first time since July 2009, following the requisite regulatory approval, on December 8, 2016, the Corporation announced the declaration of a cash dividend on its outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock for the month of December 2016. Since then, the Corporation has continued to pay monthly dividend payments on the non-cumulative perpetual monthly income preferred stock. The Corporation has received regulatory approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock through December 2019, subject to conditions established in the agreement with regulators. See the discussion under "Dividend Restrictions" under Item 1 for additional information concerning restrictions on the payment of dividends that apply to the Corporation and FirstBank.

On October 3, 2017, the Federal Reserve Board terminated the Written Agreement entered into on June 3, 2010 by the Corporation and the Federal Reserve Board. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock.

The 2011 PR Code, as amended, requires the withholding of income taxes from dividend income sourced within Puerto Rico to be received by any individual, resident of Puerto Rico or not, trusts and estates and by non-resident custodians, partnerships, and corporations.

Residents of Puerto Rico

A special tax of 15% withheld at source is imposed, in lieu of a regular tax, on any eligible dividends paid to individuals, trusts, and estates. Eligible dividends include dividends paid by a domestic Puerto Rico corporation. However, the taxpayer can perform an election to be excluded from the 15% special tax and be taxed at regular rates. Once this election is made it is irrevocable. The election allows the taxpayer to include in ordinary income the eligible dividends received and take a credit for the amount of tax withheld in excess, if any.

Nonresident U.S. Citizens

Dividends paid to a U.S. citizen who is not a resident of Puerto Rico will be subject to a 15% income tax. Nonresident U.S. citizens have the right to partial or total exemptions when a Withholding Tax Exemption Certificate (PR Treasury Department Form AS 2732) is properly completed and filed with the Corporation. The Corporation, as withholding agent, is authorized to withhold a tax of 15% only from the excess of the income paid over the applicable tax-exempt amount.

Nonresident individuals that are non US citizens

Dividends paid to any individual who is not a citizen of the United States and who is not a resident of Puerto Rico will generally be subject to a 15% Puerto Rico income tax which will be withheld at source.

Foreign Corporations and Partnerships

Corporations and partnerships not organized under Puerto Rico laws that have not engaged in a trade or business in Puerto Rico during the taxable year in which the dividend, if any, is paid are subject to the 10% dividend tax withholding. Corporations or partnerships not organized under the laws of Puerto Rico that have engaged in a trade or business in Puerto Rico are not subject to the 10% withholding, but they must declare any dividend as ordinary income on their Puerto Rico income tax return.

Securities authorized for issuance under equity compensation plans

The following table summarizes equity compensation plans approved by security holders and equity compensation plans that were not approved by security holders as of December 31, 2018:

Plan category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, warrants and rights	(b) Weighted Average Exercise Price of Outstanding Options, warrants and rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans, approved by stockholders	-	$ -	6,897,855[(1)]
Equity compensation plans not approved by stockholders	N/A	N/A	N/A
Total	-	$ -	6,897,855

(1) Securities available for future issuance under the First BanCorp. 2008 Omnibus Incentive Plan (the "Omnibus Plan"), which was initially approved by stockholders on April 29, 2008. Most recently, on May 24, 2016, the Omnibus Plan was amended to, among other things, increase the number of shares of common stock reserved for issuance under the Omnibus Plan, to extend the term of the Omnibus Plan to May 24, 2026 and to re-approve the material terms of the performance goals under the Omnibus Plan for purpose of the then effective Section 162(m) of the U.S. Internal Revenue Code of 1986, as amended. The Omnibus Plan provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. As amended, this plan provides for the issuance of up to 14,169,807 shares of common stock, subject to adjustments for stock splits, reorganization and other similar events. As of December 31, 2018, 6,897,855 shares of Common Stock were available for future issuance under the Omnibus Plan.

Purchase of equity securities by the issuer and affiliated purchasers

The following table provides information relating to the Corporation's purchases of shares of its common stock in the three-month period ended December 31, 2018:

Period	Total number of shares purchased [(1)]	Average Price Paid	Total Number of Shares Purchased as Part of Publicly Announced Plans Or Programs	Maximum Number of Shares That May Yet be Purchased Under These Plans or Programs
October, 2018	-	$ -	-	-

November, 2018	-		-	-	-
December, 2018	704		8.71	-	-
Total	704	$	8.71	-	-

(1) Reflects the withholding of shares of common stock to cover minimum tax withholding obligations from the common stock upon vesting of restricted stock. The Corporation intends to continue to satisfy statutory tax withholding obligations in connection with the vesting of outstanding restricted stock through the withholding of shares.

STOCK PERFORMANCE GRAPH

The following Performance Graph shall not be deemed incorporated by reference by any general statement incorporating by reference this Annual Report on Form 10-K into any filing under the Securities Act or the Exchange Act, except to the extent that First BanCorp. specifically incorporates this information by reference, and shall not otherwise be deemed filed under these Acts.

The graph below compares the cumulative total stockholder return of First BanCorp. during the measurement period with the cumulative total return, assuming reinvestment of dividends, the S&P 500 Index and the S&P Supercom Banks Index (the “Peer Group”). The Performance Graph assumes that $100 was invested on December 31, 2013 in each of First BanCorp. common stock, the S&P 500 Index and the Peer Group. The comparisons in this table are set forth in response to SEC disclosure requirements, and are therefore not intended to forecast or be indicative of future performance of First BanCorp.’s common stock.

The cumulative total stockholder return was obtained by dividing (i) the cumulative amount of dividends per share, assuming dividend reinvestment since the measurement point, December 31, 2013 plus (ii) the change in the per share price since the measurement date, by the share price at the measurement date.

Item 6. Selected Financial Data

The following table sets forth certain selected consolidated financial data for each of the five years in the period ended December 31, 2018. This information should be read in conjunction with the audited consolidated financial statements and the related notes thereto.

SELECTED FINANCIAL DATA

	Year Ended December 31,				
(In thousands, except for per share and financial ratios)	**2018**	**2017**	**2016**	**2015**	**2014**
Condensed Income Statements:					
Total interest income	$ 624,967	$ 588,423	$ 585,292	$ 605,569	$ 633,94
Total interest expense	99,854	96,872	101,174	103,303	115,87
Net interest income	525,383	491,551	484,118	502,266	518,07
Provision for loan and lease losses	59,253	144,254	86,733	172,045	109,53
Non-interest income	82,310	62,387	87,954	81,325	61,34
Non-interest expenses	357,802	347,701	355,080	383,830	378,25
Income before income taxes	190,638	61,983	130,259	27,716	91,63
Income tax benefit (expense)	10,970	4,973	(37,030)	(6,419)	300,64
Net income	201,608	66,956	93,229	21,297	392,28
Net income attributable to common stockholders - basic	198,932	64,280	93,006	21,297	393,94
Net income attributable to common stockholders - diluted	198,932	64,280	93,006	21,297	393,94
Per Common Share Results:					
Net earnings per common share - basic	$ 0.92	$ 0.30	$ 0.44	$ 0.10	$ 1.8
Net earnings per common share - diluted	$ 0.92	$ 0.30	$ 0.43	$ 0.10	$ 1.8
Cash dividends declared	$ 0.03	-	-	-	
Average shares outstanding	215,709	213,963	212,818	211,457	208,75
Average shares outstanding diluted	216,677	216,118	215,794	212,971	210,54
Book value per common share	$ 9.25	$ 8.48	$ 8.05	$ 7.71	$ 7.6
Tangible book value per common share (1)	$ 9.07	$ 8.28	$ 7.83	$ 7.47	$ 7.4
Dividend payout ratio (percent %)	3.25	-	-	-	
Balance Sheet Data:					
Total loans, including loans held for sale	$ 8,901,309	$ 8,883,456	$ 8,936,879	$ 9,148,251	$ 9,177,37
Allowance for loan and lease losses	192,362	231,843	205,603	240,710	222,39
Money market and investment securities	2,139,503	2,095,177	2,091,196	2,299,520	2,170,40
Intangible assets	38,757	42,351	46,754	50,583	49,90
Deferred tax asset, net	319,851	294,809	281,657	311,263	313,04
Total assets	12,243,561	12,261,268	11,922,455	12,573,019	12,727,83
Deposits	8,994,714	9,022,631	8,831,205	9,338,124	9,483,94
Borrowings	1,074,236	1,223,635	1,186,187	1,381,492	1,456,95
Total preferred equity	36,104	36,104	36,104	36,104	36,10
Total common equity	2,049,015	1,853,608	1,784,529	1,685,779	1,653,99
Accumulated other comprehensive loss, net of tax	(40,415)	(20,615)	(34,390)	(27,749)	(18,35
Total equity	2,044,704	1,869,097	1,786,243	1,694,134	1,671,74

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Selected Financial Ratios (In Percent):					
Profitability:					
Return on Average Assets	1.65	0.56	0.75	0.17	3.10
Return on Average Total Equity	10.64	3.63	5.28	1.26	30.25
Return on Average Common Equity	10.85	3.71	5.39	1.29	31.38
Average Total Equity to Average Total Assets	15.52	15.39	14.25	13.23	10.25
Interest Rate Spread	4.15	4.07	3.88	3.94	4.02
Interest Rate Margin	4.55	4.36	4.14	4.15	4.20
Interest Rate Spread - tax equivalent basis (2)	4.34	4.22	3.99	4.08	4.16
Interest Rate Margin - tax equivalent basis (2)	4.74	4.51	4.25	4.30	4.34
Tangible common equity ratio (1)	16.14	14.65	14.34	12.84	12.51
Efficiency ratio (3)	58.88	62.77	62.07	65.77	65.28
Asset Quality:					
Allowance for loan and lease losses to loans held for investment	2.22	2.62	2.31	2.64	2.44
Net charge-offs to average loans (4)	1.09	1.33	1.37	1.68	1.84
Provision for loan and lease losses to net charge-offs	0.63x	1.22x	0.71x	1.12x	0.63x
Non-performing assets to total assets (4)	3.81	5.31	6.16	4.85	5.63
Nonaccrual loans held for investment to total loans held for investment (4)	3.57	5.53	6.30	4.86	5.76
Allowance to total nonaccrual loans held for investment	62.15	47.36	36.71	54.36	42.45
Allowance to total nonaccrual loans held for investment, excluding residential real estate loans	116.41	74.48	51.50	87.92	64.80
Other Information:					
Common stock price: End of period	$ 8.60	$ 5.10	$ 6.61	$ 3.25	$ 5.87

(1) Non-GAAP financial measures. Refer to "Capital" below for additional information about the components and a reconciliation of these measures.
(2) On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments (see "Net Interest Income" below for a reconciliation of these non-GAAP financial measures).
(3) Non-interest expenses to the sum of net interest income and non-interest income.
(4) Loans used in the denominator in calculating each of these ratios include purchased credit-impaired loans. However, the Corporation separately tracks and reports purchased credit-impaired loans and excludes these from nonaccrual loan and non-performing asset amounts.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)

The following Management's Discussion and Analysis of Financial Condition and Results of Operations relates to the accompanying audited consolidated financial statements of First BanCorp. and should be read in conjunction with such financial statements and the notes thereto. This section also presents certain financial measures that are not based on generally accepted accounting principles in the United States ("GAAP"). See "Basis of Presentation" below for information about why the non-GAAP financial measures are being presented and the reconciliation of the non-GAAP financial measures for which the reconciliation is not presented earlier.

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 (the "Holding Company") of FirstBank Puerto Rico and FirstBank Insurance Agency. Through its wholly-owned subsidiaries, the Corporation operates offices in Puerto Rico, the United States Virgin Islands and British Virgin Islands, and the State of Florida (USA), concentrating on commercial banking, residential mortgage loan originations, finance leases, credit cards, personal loans, small loans, auto loans, and insurance agency activities. On August 1, 2018, the Bank's Board of Directors approved a resolution to dissolve the broker-dealer subsidiary FirstBank Securities. Accordingly, FirstBank Securities filed the required Form BDW for the withdrawal of its registration from the SEC and the Financial Industry Regulatory Authority and its license to operate as broker-dealer was terminated effective September 30, 2018. Management is in the process of completing the dissolution of FirstBank Securities as a legal entity under the state laws.

EXECUTIVE Overview of Results of Operations

First BanCorp.'s results of operations depend primarily on 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, non-interest expenses (such as personnel, occupancy, the deposit insurance premium and other costs), non-interest income (mainly service charges and fees on deposits, and insurance income), gains (losses) on sales of investments, gains (losses) on mortgage banking activities, and income taxes.

The Corporation had net income of $201.6 million, or $0.92 per diluted common share, for the year ended December 31, 2018, compared to a $67.0 million, or $0.30 per diluted common share, for 2017, and $93.2 million, or $0.43 per diluted common share, for 2016.

The key drivers of the Corporation’s GAAP financial results for the year ended December 31, 2018 and 2017, include the following:

- Net interest income for the year ended December 31, 2018 was $525.4 million compared to $491.6 million and $484.1 million for the years ended December 31, 2017 and 2016, respectively. The increase for 2018 compared to 2017 was primarily driven by: (i) a $17.2 million increase in interest income on commercial and construction loans, primarily associated with the upward repricing of variable rate commercial loans; (ii) a $9.1 million increase in interest income on investment securities, primarily due to the gradual reinvestment of liquidity and proceeds from maturing debt securities into higher-yielding U.S. agencies debt securities and MBS; (iii) a $7.5 million increase in interest income on consumer loans, mainly due to a $77.8 million increase in the average balance of this portfolio, primarily auto loans and finance leases; and (iv) a $6.5 million increase in interest income from interest-bearing cash balances, primarily deposits maintained at the Federal Reserve Bank of New York, due to both a higher average balance and increases in the Federal Funds target rate.

These variances were partially offset by: (i) a $3.7 million decrease in interest income on residential mortgage loans, primarily associated with an $81.2 million decrease in the average balance of this portfolio; and (ii) a $2.7 million increase in total interest expense, driven an increase in the use of long-term FHLB advances during 2018 and higher market interest rates on the cost of retail CDs and commercial money market accounts tied to variable short-term interest rates, partially offset by a $480.3 million decrease in the average balance of brokered CDs.

The net interest margin increased to 4.55% for the year ended December 31, 2018 compared to 4.36% for 2017, primarily due to the aforementioned upward repricing of variable rate commercial loans, the gradual reinvestment of liquidity in higher-yielding securities, and an improved funding mix, driven by the increase in the proportion of interest-earning assets funded by the growth in non-interest bearing deposits.

The increase for 2017 compared to 2016 was primarily driven by: (i) a $12.5 million increase in interest income on commercial and construction loans, primarily associated with both the upward repricing of variable rate commercial loans and the growth of the performing commercial portfolios, primarily in the Florida region; (ii) a $4.3 million decrease in interest expense, including a decrease of $2.8 million in interest expense on brokered CDs, primarily related to a $509.0 million decrease in the average balance of brokered CDs that offset higher costs on new issuances, and a $9.3 million decrease in interest expense on repurchase agreements, primarily reflecting the full-year effect of the repayment of $400 million of repurchase agreements that matured in the third and fourth quarters of 2016 and carried an average cost of 3.35%, partially offset by increases of $5.2 million and $2.0 million in interest expense on FHLB advances and non-brokered deposits, respectively; and (iii) a $1.2 million increase in interest income from deposits maintained at the Federal Reserve Bank of New York, due to increases in the Federal Funds target rate in 2017 and late in 2016.

The aforementioned variances were partially offset by: (i) a $5.6 million decrease in interest income on consumer loans and finance leases, primarily reflecting a $33.5 million decrease in the average balance of this portfolio, primarily auto loans, and, to a lesser extent, the effect of a $1.4 million decrease in late payment fees as the Corporation did not assess late charges during the fourth quarter of 2017 to customers affected by Hurricanes Irma and Maria that qualified for the three-month payment deferral program established by the Corporation after the hurricanes; and (ii) a $5.3 million decrease in interest income on residential mortgage loans, reflecting both a higher level of inflows of residential mortgage loans to non-performing status and a $41.8 million decrease in the average balance of this portfolio.

- The provision for loan and lease losses for the year ended December 31, 2018 was $59.3 million compared to $144.3 million and $86.7 million for 2017 and 2016, respectively. During 2018, the Corporation recorded a net loan loss reserve release of $16.9 million in connection with revised estimates of the hurricane-related qualitative reserves associated with the effects of Hurricanes Irma and Maria, compared to hurricane-related charges to the provision of $71.3 million recorded in 2017. See “Results of Operations – Provision for Loan and Lease Losses” below for details about the Corporation’s approach to the estimation of hurricane-related qualitative reserves. On a non-GAAP basis, excluding the aforementioned effects of the hurricane-related qualitative reserves, the adjusted provision for loan and lease losses for 2018 was $76.2 million compared to $73.0 million and $86.7 million for 2017 and 2016, respectively. The increase in the adjusted provision for loan and lease losses for 2018 compared to 2017 was primarily driven by a $26.2 million increase in the adjusted provision for loan and lease losses for commercial and construction loans, driven by charges of $22.3 million related to developments in problem loans resolution strategies, including a $15.7 million charge on loans transferred to held for sale during 2018, partially offset by a $22.6 million decrease in the adjusted provision for residential mortgage loans, primarily reflecting a decline in charge-offs, nonaccrual and delinquent loan levels, and the overall decrease in the size of this portfolio.

The decrease in the adjusted provision for loan and lease losses for 2017 compared to 2016 was primarily driven by: (i) a $22.1 million decrease in the adjusted provision for commercial and construction loans reflecting, among other things, lower specific reserve requirements for impaired loans and a $2.9 million increase in loan loss recoveries; and (ii) a $2.8 million decrease in the adjusted provision for consumer loans and finance leases, mainly related to lower levels of personal and small loans delinquencies. These variances were partially offset by an $11.1 million increase in the adjusted provision for residential mortgage loans, primarily related to a higher level of residential nonaccrual loans, increased specific reserves for residential mortgage TDRs, and higher loss severity estimates in 2017.

See "Basis of Presentation" below for additional information and reconciliation of the provision for loan and lease losses in accordance with GAAP to the non-GAAP adjusted provision for loan and lease losses.

Net charge-offs totaled $94.7 million for the year ended December 31, 2018, or 1.09% of average loans, a decrease of $23.3 million, compared to net charge-offs of $118.0 million, or 1.33% of average loans, for 2017 and $121.8 million, or 1.37% of average loans, for 2016. The decrease in 2018, compared to 2017, primarily reflects a $24.0 million decrease in net charge-offs taken on commercial and construction loans and a $4.4 million decrease in net charge-offs of residential mortgage loans, partially offset by a $5.1 million increase in net charge-offs taken on consumer loans. During 2018, the Corporation recorded a loan loss recovery of $7.4 million on a commercial mortgage TDR loan paid off during the year compared to charge-offs of $27.3 million taken on such loan in 2017. This variance was partially offset by the effect in 2018 of charge-offs totaling $12.5 million taken on nonaccrual commercial and construction loans transferred to held for sale. See "Results of Operations – Provision for Loan and Lease Losses" and "Risk Management – Allowance for Loan and Lease Losses and Non-Performing Assets" below for an analysis of the allowance for loan and lease losses and non-performing assets and related ratios.

- The Corporation recorded non-interest income of $82.3 million for the year ended December 31, 2018 compared to $62.4 million and $88.0 million for the years ended December 31, 2017 and 2016, respectively. The increase for 2018 compared to 2017 was primarily driven by: (i) the effect in 2017 of a $12.2 million other-than-temporary impairment ("OTTI") charge on three Puerto Rico Government debt securities, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority; (ii) a $3.7 million increase in revenues from mortgage banking activities, driven by adjustments recorded in 2018 that reduced the valuation allowance of mortgage servicing rights and higher servicing fees; (iii) a $3.6 million increase in fee-based income from ATMs, POS, credit and debit cards, and merchant-related activities; and (iv) a $1.2 million increase in gains from sales of fixed assets, primarily assets of relocated or closed banking branches in Florida and Puerto Rico. These variances were partially offset by a $2.8 million net loss recorded on sales of nonaccrual commercial and construction loans held for sale completed in 2018.

The decrease for 2017 compared to 2016 was primarily driven by: (i) a $6.9 million decrease in revenues from mortgage banking activities, primarily due to lower conforming loan origination and sales volume associated with both the drop in business activity in Puerto Rico and the Virgin Islands after the hurricanes and higher market interest rates; (ii) the effect in 2016 of a $6.1 million gain on sales of $198.7 million of U.S. agency MBS; (iii) a $5.9 million increase in OTTI charges on bonds of the GDB and the Puerto Rico Public Buildings Authority; (iv) a $2.9 million decrease in gains associated with repurchases and cancellations of trust-preferred securities; (v) the effect in 2016 of a $1.5 million gain from the recovery of a residual collateralized mortgage obligation ("CMO") previously written off; and (vi) the effect in 2016 of brokerage and insurance commissions of $1.8 million, primarily related to the sale of large fixed annuities contracts.

- Non-interest expenses for 2018 were $357.8 million compared to $347.7 million and $355.1 million for 2017 and 2016, respectively. The increase for 2018 compared to 2017 was primarily driven by: (i) a $7.6 million increase in employees' compensation and benefit expenses reflecting, among other things, salary merit increases and adjustments related to the Corporation's annual salary review process, higher headcount, and an increase in the Bank's matching contribution to the employees' retirement plans; (ii) a $3.5 million increase in losses from OREO operations reflecting, among other things, a $2.1 million increase in adverse fair value adjustments to the value of OREO properties and a $1.3 million increase in OREO operating expenses, including taxes, insurance and maintenance fees; (iii) a $2.3 million increase in business promotion expenses, primarily due to increased advertising, marketing, promotions and sponsorship-related activities during 2018; and (iv) a $1.3 million increase in occupancy and equipment costs, primarily due to hurricane-related expenses incurred in 2018 associated with repairs and security matters. These variances were partially offset by a $4.8 million decrease in the FDIC insurance premium expense due to, among other things, improved earnings trends, reduction in brokered CDs, and higher liquidity levels tied to the growth in non-interest bearing deposits.

The decrease for 2017 compared to 2016 was primarily due to: (i) a $6.3 million decrease in the FDIC insurance premium expense, mainly related to the effect of reductions in brokered deposits and average assets, a strengthened capital position, and improved liquidity metrics; (ii) a $2.1 million decrease in the provision for unfunded loan commitments and letters of credit; (iii) a $0.8 million decrease in write-downs, loss on sales and expenses related to non-real estate repossessed assets; (iv) a $0.6 million decrease in communications-related matters such as telephone and postage expenses; (v) a $0.6 million decrease in taxes, other than income taxes, primarily related to decreases in the sales and use tax expense and in municipal license taxes in Puerto Rico; (vi) a $0.5 million decrease in losses from OREO operations, primarily reflecting a $1.8 million decrease in write-downs to the value of OREO properties, partially offset by a $1.2 million decrease in rental income from commercial OREO income-producing properties; and (vii) a $0.4 million decrease in credit and debit card processing expenses, primarily associated with a lower volume of transactions affected by the drop in business activity after the hurricanes in 2017. These variances were partially offset by: (i) a $1.8 million increase in professional service fees, primarily reflecting higher consulting fees related to the implementation of new technology systems and higher outsourcing fees related to network services; (ii) a $1.5 million increase in occupancy and equipment costs, primarily due to higher electricity expenses, property taxes and rental expenses; (iii) a $1.1 million increase in business promotion expenses, reflecting the effect in 2016 of a $2.7 million adjustment recorded to reduce the credit card rewards program liability due to the expiration of reward points earned by customers up to September 2013 (the conversion date of the credit card portfolio acquired from FIA in May 2012) and costs of approximately $1.0 million related to hurricane relief efforts and assistance to employees incurred in 2017, partially offset by a $1.3 million decrease associated with lower advertising and marketing-related activities.

- For 2018, the Corporation recorded an income tax benefit of $11.0 million compared to income tax benefit of $5.0 million for 2017 and income tax expense of $37.0 million for 2016. The income tax benefit recorded in 2018 reflects, among other things, the effect of a $63.2 million benefit related to a partial reversal of the deferred tax asset valuation allowance, partially offset by a one-time charge of $9.9 million associated with the remeasurement of deferred tax assets resulting from the enactment of Act 257 (net of the $5.6 million related impact in the valuation allowance). The income tax benefit recorded in 2017 reflects the effect of the tax benefit related to hurricane-related charges to the provision for loan and lease losses and a $13.2 million tax benefit recorded as a result of the change in tax status of certain subsidiaries from taxable corporations to limited liability companies that have elected to be treated as partnerships for income tax purposes in Puerto Rico. As of December 31, 2018, the Corporation had a net deferred tax asset of $319.9 million (net of a valuation allowance of $100.7 million, including a valuation allowance of $68.1 million against the deferred tax assets of the Corporation's banking subsidiary, FirstBank). See " Results of Operations – Income Taxes" below for additional information.

- As of December 31, 2018, total assets were approximately $12.2 billion, a decrease of $17.7 million from December 31, 2017. The decrease primarily reflects a $130.2 million decrease in cash and cash equivalents, largely driven by liquidity used for the repayment of $657.9 million of maturing brokered CDs, the repayment of $200 million of repurchase agreements, the repurchase of $23.8 million of trust-preferred securities, and liquidity reinvested in higher-yielding U.S. agencies debt and MBS, partially offset by liquidity obtained from the growth in non-interest bearing deposits. In addition, the OREO portfolio balance decreased by $16.5 million.

The aforementioned decreases were partially offset by a $51.6 million increase in available-for-sale investment securities, driven by purchases of U.S agencies MBS and debt securities, a $25.0 million increase in the net deferred tax asset, and a $17.9 million increase in total loans. The decrease in total loans reflects a growth of $168.6 million in the Florida region, partially offset by decreases of $103.4 million and $47.4 million in the Virgin Islands and Puerto Rico, respectively. Total loans for 2018 reflect an increase in the consumer loan portfolio of $194.8 million, partially offset by reductions of $125.4 million and $51.6 million in the residential mortgage and commercial and construction loan portfolios, respectively. The allowance for loan and lease losses decreased by $35.5 million during 2018 reflecting, among other things, the effect of releases associated with revised estimates of the hurricane-related qualitative reserve. See "Financial Condition and Operating Data Analysis – Assets" below for additional information.

- As of December 31, 2018, total liabilities were $10.2 billion, a decrease of $193.3 million from December 31, 2017. The decrease was mainly related to: (i) a $594.9 million decrease in brokered CDs; (ii) a $149.9 million decrease in repurchase agreements; and (iii) the repurchase of $23.8 million of trust-preferred securities. These reductions were partially offset by a $318.2 million increase in deposits, excluding brokered CDs and government deposits, a $248.8 million increase in government deposits, and a $25.0 million increase in FHLB advances. A significant portion of the increase in non-brokered deposits was in noninterest-bearing demand deposits, which grew 31%, or $561.8 million which, in part, reflects the effect of hurricane-related factors such as settlements of insurance claims and disaster relief funds. See "Risk Management – Liquidity and Capital Adequacy" below for additional information about the Corporation's funding sources.

- As of December 31, 2018, the Corporation's stockholders' equity was $2.0 billion, an increase of $175.6 million from December 31, 2017. The increase was mainly driven by the earnings generated in 2018, partially offset by the decrease in the fair value of available-for-sale investment securities recorded as part of other comprehensive loss in total equity and dividends paid on preferred and common stock. During the fourth quarter of 2018, for the first time since June 2009, the Corporation declared a quarterly cash dividend of $0.03 per common share, or an aggregate of $6.5 million. In addition, the Corporation continued to pay monthly dividends on its non-cumulative perpetual monthly income preferred stock totaling $2.7 million in 2018. The Corporation's Total Capital, Common equity Tier 1 Capital, Tier 1 Capital and Leverage ratios calculated under the Basel III rules were 24.00%, 20.30%, 20.71%, and 15.37%, respectively, as of December 31, 2018, compared to Total Capital, Common equity Tier 1 Capital, Tier 1 Capital and Leverage ratios of 22.53%, 18.96%, 18.97%, and 14.03%, respectively, as of December 31, 2017. The Corporation's tangible common equity ratio increased to 16.14% as of December 31, 2018, from 14.65% as of December 31, 2017. See "Risk Management – Capital" below for additional information.

- Total loan production, including purchases, refinancings, renewals and draws from existing revolving and non-revolving commitments, was $3.1 billion and $2.9 billion for years ended December 31, 2018 and 2017, respectively, excluding the utilization activity on outstanding credit cards. Total loan originations in the Puerto Rico region of $2.4 billion increased by $304.4 million, compared to 2017. The growth in the Puerto Rico region consisted of increases of $237.6 million, $45.5 million, and $21.3 million in consumer, residential, and commercial loans, respectively. In addition, total loan originations in the Virgin Islands increased by $26.9 million. Total loan originations in the Florida region decreased by $92.4 million, primarily reflected in lower residential mortgage loan originations.

- Total non-performing assets were $467.1 million as of December 31, 2018, a decrease of $183.5 million from December 31, 2017. The decrease was primarily attributable to: (i) the restoration to accrual status of two large commercial loans totaling $69.7 million; (ii) sales of $61.9 million of nonaccrual commercial and construction loans held for sale; (iii) collections on commercial and construction nonaccrual loans of $32.3 million; (iv) commercial and construction nonaccrual loan charge-offs totaling $40.3 million; (v) a $31.0 million decrease in residential nonaccrual loans, and (vi) a $16.5 million decrease in the OREO portfolio balance. These variances were partially offset by the inflow of two large commercial mortgage loans totaling $69.8 million related to a legacy commercial loan relationship that operates in both the Florida and Puerto Rico regions with independent sources of repayment. See "Risk Management - Non-accruing and Non-performing Assets" below for additional information.

- Adversely classified commercial and construction loans, including loans held for sale, decreased by $126.4 million to $356.0 million as of December 31, 2018, driven primarily by the sale of five large commercial and construction loans totaling $66.1 million, the upgrade in the credit risk classification of several commercial loans totaling $125.7 million, and collections and charge-offs recorded during 2018. These variances were partially offset by the downgrade in the credit risk classification of three large commercial loans totaling $110.4 million, including the aforementioned $69.8 million in two large commercial loans classified as nonaccrual during 2018.

The Corporation’s financial results for 2018, 2017 and 2016 included the following significant items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts (the “Special Items”):

Year ended December 31, 2018

- Tax benefit of $63.2 million resulting from the partial reversal of the Corporation’s deferred tax asset valuation allowance.

- One-time charge to the income tax expense of $9.9 million related to the enactment of the Puerto Rico Tax Reform of 2018, specifically in connection with the reduction of the Corporation’s deferred tax assets as a result of the decrease in the maximum corporate tax rate in Puerto Rico from 39% to 37.5%.

- Net loan loss reserve releases of $16.9 million ($10.3 million after-tax) in connection with revised estimates of the qualitative reserves associated with the effects of Hurricanes Maria and Irma. See “Results of Operations - Provision for Loan and Lease Losses” below for additional information.

- Gain of $0.5 million ($0.3 million after-tax) resulting from hurricane-related insurance proceeds in excess of fixed-asset impairment charges.

- Hurricane-related expenses of $2.8 million ($1.7 million after-tax).

- Gain of $2.3 million on the repurchase and cancellation of $23.8 million in trust-preferred securities, reflected in the consolidated statement of income as “Gain on early extinguishment of debt.” The gain, realized at the holding company level, had no effect on the income tax expense in 2018. See “Results of Operation - Non-Interest Income” below for additional information.

<u>Year ended December 31, 2017</u>

- Tax benefit of $13.2 million associated with the change in tax status of certain subsidiaries from taxable corporations to limited liability companies that made an election to be treated as partnerships for income tax purposes in Puerto Rico. See "Income Taxes" discussion below for additional information.

- Charges to the provision for loan and lease losses of $71.3 million ($43.5 million after-tax) related to the estimate of inherent losses resulting from the effects of Hurricanes Irma and Maria.

- Hurricane-related expenses of $2.5 million ($1.6 million after-tax).

- Expected insurance recoveries of $1.8 million for compensation and rental costs that the Corporation incurred when Hurricanes Maria and Irma precluded employees from working in 2017.

- OTTI charge of $12.2 million and a $0.4 million recovery of previously recorded OTTI charges on non-performing bonds of the GDB and the Puerto Rico Public Buildings Authority sold in 2017. No tax benefit was recognized for the OTTI charge and the recovery on the sale of the bonds.

- Gain of $1.4 million on the repurchase and cancellation of $7.3 million in trust-preferred securities, reflected in the consolidated statements of income as “Gain on early extinguishment of debt.” The gain, realized at the holding company level, had no effect on the income tax expense in 2017.

- Costs of $0.4 million associated with the secondary offerings of the Corporation’s common stock by certain of our existing stockholders in 2017. The costs, incurred at the holding company level, had no effect on the income tax expense in 2017.

Year ended December 31, 2016

- OTTI charges of $6.7 million on debt securities, primarily on the aforementioned bonds of the GDB and the Puerto Rico Public Buildings Authority. No tax benefit was recognized for the OTTI charges in 2016.

- Gain of $6.1 million ($5.9 million after-tax) on sales of $198.7 million of U.S. agency MBS that carried an average yield of 2.36%.

- Gain of $4.2 million on the repurchase and cancellation of $10 million in trust-preferred securities, reflected in the consolidated statements of income as “Gain on early extinguishment of debt.” The gain, realized at the holding company level, had no effect on the income tax expense in 2016.

- Adjustment of $2.7 million ($1.7 million after tax) recorded to reduce the credit card rewards program liability due to the expiration of reward points earned by customers up to September 2013 (the conversion date of the credit card portfolio acquired from FIA in May 2012). Most of these points had been accrued at the acquisition date and ultimately experienced a redemption pattern materially different from those points accrued after the conversion

- Brokerage and insurance commissions of $1.7 million ($1.0 million after-tax) net of incentive costs, primarily from the sale of large fixed annuities contracts.

- Gain of $1.5 million ($1.2 million after-tax) from recovery of a residual CMO previously written off.

- Costs of $0.6 million associated with a secondary offering of the Corporation's common stock by certain of the existing stockholders. The costs, incurred at the holding company level, had no effect on the income tax expense in 2016.

- Severance payments of $0.3 million ($0.2 million after-tax) related to permanent job discontinuance recorded in 2016.

The following table reconciles for 2018, 2017, and 2016 the reported net income to adjusted net income, a non-GAAP financial measure that excludes the Special Items identified above:

	Year Ended December 31, 2018	2017	2016
(In thousands)			
Net income, as reported (GAAP)	$ 201,608	$ 66,956	$ 93,229
Adjustments:			
Partial reversal of deferred tax asset valuation allowance	(63,228)	-	-
Remeasurement of deferred tax assets due to changes in enacted tax rates (1)	9,892	-	-
Income tax benefit related to change in tax-status of certain subsidiaries	-	(13,161)	-
Hurricane-related loan loss reserve (release) provision	(16,943)	71,304	-
Hurricane-related gain from insurance proceeds	(478)	-	-
Hurricane-related expenses	2,783	2,544	-
Expected insurance recoveries associated with hurricane-related idle time payroll and rental costs	-	(1,819)	-
Loss (gain) on sale of investment securities	34	-	(6,104)
OTTI on debt securities	50	12,231	6,687
Recovery of previously recorded OTTI charges on Puerto Rico government debt securities sold	-	(371)	-
Gain on early extinguishment of debt	(2,316)	(1,391)	(4,217)
Gain from recovery of investments previously written off	-	-	(1,547)
Brokerage and insurance commissions, primarily from the sale of large fixed annuities contracts, net of incentive costs	-	-	(1,692)
Adjustment to reduce the credit cards rewards liability due to unusually large customer forfeitures	-	-	(2,732)
Secondary offering costs	-	392	590
Severance payments on jobs discontinuance	-	-	281
Income tax impact of adjustments (2)	5,708	(28,800)	2,111
Adjusted net income (Non-GAAP) (3)	$ 137,110	$ 107,885	$ 86,606

(1) Net of the $5.6 million related impact in the valuation allowance.
(2) See "Basis of Presentation" for the individual tax impact related to each reconciling item.
(3) The Corporation is no longer considering the effect of loans transferred to held for sale as a special item, and, thus, this effect is no longer presented as an adjustment from GAAP to non-GAAP financial measures such as adjusted net income, adjusted provision for loan and lease losses, and adjusted provision to net-charge-offs ratio.

Critical Accounting Policies and Practices

The accounting principles of the Corporation and the methods of applying these principles conform to GAAP. The Corporation's critical accounting policies relate to: 1) the allowance for loan and lease losses; 2) OTTI; 3) income taxes; 4) the classification and values of financial instruments; 5) income recognition on loans; 6) loans acquired; and 7) loans held for sale. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the amounts recorded for assets, liabilities and contingent liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates, if different assumptions or conditions prevail. Certain determinations inherently require greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than those originally reported.

Allowance for Loan and Lease Losses

The Corporation maintains the allowance for loan and lease losses at a level considered adequate to absorb incurred losses currently inherent in the loan and lease portfolio. The Corporation does not maintain an allowance for held-for-sale loans or PCI loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair values of these loans already reflect a credit component. The allowance for loan and lease losses provides for probable incurred losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable incurred losses believed to be inherent in the loan portfolio that have not been specifically identified. The determination of the allowance for loan and lease losses requires significant estimates, including with respect to the timing and amounts of expected future cash flows on impaired loans, consideration of current economic conditions and business strategies, and historical loss experience pertaining to the portfolios and pools of homogeneous loans, all of which may be susceptible to change.

The Corporation evaluates the need for changes to the allowance by portfolio loan segments and classes of loans within certain of those portfolio segments. The Corporation combines loans with similar credit risk characteristics into the following portfolio segments: commercial mortgage, construction, commercial and industrial, residential mortgage, and consumer loans. Classes are usually disaggregations of the portfolio segments. The classes within the residential mortgage segment are residential mortgages guaranteed by the U.S. government and other residential loans. The classes within the consumer portfolio are auto, finance lease, and other consumer loans. Other consumer loans mainly include unsecured personal loans, credit cards, home equity lines, lines of credits, and marine financing. The classes within the construction loan portfolio are land loans, construction of commercial projects, and construction of residential projects. The commercial mortgage and commercial and industrial segments are not further segmented into classes. The adequacy of the allowance for loan and lease losses is based on judgments related to the credit quality of each portfolio segment. These judgments consider ongoing evaluations of each portfolio segment, including such factors as the economic risks associated with each loan class, the financial condition of specific borrowers, the geography (Puerto Rico, Florida or the Virgin Islands), the level of delinquent loans, historical loss experience, the value of any collateral and, where applicable, the existence of any guarantees or other documented support. In addition to the general economic conditions and other factors described above, additional factors considered include the internal risk ratings assigned to loans. An internal risk rating is assigned to each commercial and construction loan at the time of approval and is subject to subsequent periodic review by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation’s continued evaluation of its asset quality.

The allowance for loan and lease losses is increased through a provision for credit losses that is charged to earnings, based on the quarterly evaluation of the factors previously mentioned, and is reduced by charge-offs, net of recoveries.

The allowance for loan and lease losses consists of specific reserves based upon valuations of loans considered to be impaired and general reserves. A specific valuation allowance is established for individual impaired loans in the commercial mortgage, construction, and commercial and industrial portfolios and certain boat loans, residential mortgage loans, and home equity lines of credit, primarily when the collateral value of the loan (if the impaired loan is determined to be collateral dependent) or the present value of the expected future cash flows discounted at the loan’s effective rate is lower than the carrying amount of that loan. The loans within the commercial mortgage, construction, and commercial and industrial portfolios, and boat loans of $1 million or more are individually evaluated for impairment. Also, certain residential mortgage loans and home equity lines of credit are individually evaluated for impairment purposes based on their delinquency and loan to value levels. When foreclosure of a collateral dependent loan is probable, the impairment measure is 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 generally updated annually thereafter according to the Corporation’s appraisal policy. In addition, appraisals and/or appraiser price opinions are also obtained for residential mortgage loans based on specific characteristics such as delinquency levels, age of the appraisal, and loan-to-value ratios. The excess of the recorded investment in a collateral dependent loan over the resulting fair value of the collateral is charged-off when deemed uncollectible.

For all other loans, which include small, homogeneous loans, such as auto loans, and the other classes in the consumer loan portfolio, residential mortgages and commercial and construction loans not individually evaluated for impairment, the Corporation maintains a general valuation allowance established through a process that begins with estimates of incurred losses based upon various statistical analyses. The general reserve is primarily determined by applying loss factors according to the loan type and assigned risk category (pass, special mention, and substandard loans that are not considered to be impaired; all doubtful loans are considered impaired).

The Corporation uses a roll-rate methodology to estimate losses on its consumer loan portfolio based on delinquencies and considering credit bureau score bands. The Corporation tracks the historical portfolio performance to arrive at a weighted-average distribution in each subgroup of each delinquency bucket. Roll-to-loss rates (loss factors) are calculated by multiplying the roll rates from each subgroup within the delinquency buckets forward through loss. Once roll rates are calculated, the resulting loss factor is applied to the existing receivables in the applicable subgroups within the delinquency buckets and the end results are aggregated to arrive at the required allowance level. The Corporation's assessment also involves evaluating key qualitative and environmental factors, which include credit and macroeconomic indicators such as unemployment, bankruptcy trends, recent market transactions, and collateral values to account for current market conditions that are likely to cause estimated credit losses to differ from historical loss experience. The Corporation analyzes the expected delinquency migration to determine the future volume of delinquencies.

The cash flow analysis for each residential mortgage pool is performed at the individual loan level and then aggregated to the pool level in determining the overall loss ratio (the "base methodology"). The model applies risk-adjusted prepayment curves, default curves, and severity curves to each loan in the pool. For loan restructuring pools, the present value of future cash flows under the new terms, at the loan's effective interest rate, is taken into consideration. Additionally, estimates of default risk and prepayments related to loan restructurings are based on, among other things, the historical experience of these loans. Loss severity is affected by the house price scenario, which is based in part on recent house price trends. Default curves are used in the model. The attributes that are most significant to the probability of default include present collection status (current, delinquent, in bankruptcy, in foreclosure stage), vintage, loan-to-values, and geography (Puerto Rico, Florida or the Virgin Islands). The estimates of the risk-adjusted timing of liquidations and associated costs are used in the model, and are risk-adjusted for the geographic area in which each property is located.

For commercial loans, historical charge-off rates are calculated by the Corporation on a quarterly basis for each commercial loan regulatory-based credit risk category (*i.e.* pass, special mention, substandard, and doubtful) using the historical charge-offs and portfolio balances over their average loss emergence period (the "raw loss rate") for each credit risk classification. However, when not enough loss experience is observed in a particular risk-rated category and the calculation results in a loss rate for such risk-rated category that is lower than the loss rate of a less severe risk-rated category, the Corporation uses the loss rate of such less severe category. A qualitative factor adjustment is applied to the base rate average utilizing a resulting factor derived from a set of risk-based ratings and weights assigned to credit and economic indicators over a reasonable period applied to a developed expected range of historical losses and a basis point adjustment derived from the difference between the average raw loss rate and the highest loss rate observed during a look-back period that management determined was appropriate to use for each region to identify any relevant effect during an economic cycle.

Hurricane-related Allowance for Loan and Lease Losses

During 2017, management established a separate qualitative element of the allowance to estimate inherent losses associated with the effect of Hurricanes Maria and Irma on the Corporation's loan portfolios in Puerto Rico and Virgin Islands. This qualitative element of the allowance was initially determined based on the estimated effect that the hurricanes could have on employment levels (*e.g.*, an unemployment rate that significantly increases from levels in Puerto Rico at the time of the hurricanes based on statistics observed in the aftermath of similar natural disasters in the U.S. mainland like Hurricane Katrina), economic activity in the Corporation's geographic regions, and the time it could take for the affected regions to return to a more normalized operating environment.

For large commercial and construction loan relationships, loan officers performed individual reviews of the effect of the hurricanes on these borrowers' sources of repayment. These large relationships, that represented 80% of the outstanding balance of the Corporation's commercial and construction loan portfolio at the time of the hurricanes, were analyzed and divided into three hurricane-affected categories *(i.e.* Low, Medium and High). Clients categorized as Low had no effect, or relatively insignificant effect, as a result of the storms. Clients in the Medium category had demonstrated that they had sufficient liquidity to satisfy their obligations, but the complexity of the insurance claim process may affect their primary or secondary source of repayment. Finally, clients categorized as High could potentially have problems with their primary or secondary sources of repayment as they have a higher degree of uncertainty with respect to the timing of the insurance claim resolution, and the full reestablishment of their businesses is highly dependent on the timely receipt of insurance proceeds. Reserve levels were then recognized for these particular loans based on this stratification. For loans in the Low category, no additional qualitative hurricane-related reserve was calculated. For loans in the Medium and High categories, the Corporation stressed the general reserve loss factors applicable to these loans to reflect higher default probabilities not reflected in the historical data.

This review also resulted in downgrades in the credit risk classification of certain loans and their reserves were determined following the methodology applicable to criticized and adversely classified loans, as appropriate.

During 2018, the Corporation performed additional procedures to evaluate the adequacy of the qualitative reserve, including the consideration of updated payment patterns and probability of default credit risk analyses applied to consumer loan borrowers subject to payment deferral programs that expired early in 2018. For the determination of the hurricane-related qualitative reserve for residential mortgage loans as of December 31, 2018, the Corporation stressed the loss factors derived from its above-described base methodology by incorporating assumptions of further deterioration in the housing price index and higher loan modification levels. Although the foreclosure moratoriums extended by the FHA to hurricane-affected individuals ended on September 15, 2018, there are likely to be additional delays in foreclosure actions due to court-related backlogs. For the determination of the hurricane-related qualitative reserve for commercial and construction loans not individually reviewed as of December 31, 2018, the Corporation segregated the portfolio based on delinquency levels and stressed the general reserve loss factors applicable to 30-89 days past due loans to reflect higher default probabilities.

As a result of the aforementioned analyses, the Corporation recorded a net loan loss reserve release of $16.9 million in 2018 and a charge to the provision of $71.3 million in 2017 associated with the hurricanes. As of December 31, 2018, the hurricane-related qualitative allowance was $19.2 million (2017 - $55.6 million). See “Results of Operations - Provision for Loan and Lease Losses” below for additional information, including details about the hurricane-related qualitative allowance segregated by loans portfolio segments.

Charge-off of Uncollectible Loans - Net charge-offs consist of the unpaid principal balances of loans held for investment that the Corporation determines are uncollectible, net of recovered amounts. Charge-offs are recorded as a reduction to the allowance for loan and lease losses and subsequent recoveries of previously charged off amounts are credited to the allowance for loan and lease losses. Collateral dependent loans in the construction, commercial mortgage, and commercial and industrial loan portfolios are charged off to their net realizable value (fair value of collateral, less estimated costs to sell) when loans are considered to be uncollectible. Within the consumer loan portfolio, auto loans and finance leases are reserved once they are 120 days delinquent and are charged off to their estimated net realizable value when the collateral deficiency is deemed uncollectible (*i.e.*, when foreclosure/repossession is probable) or when the loan is 365 days past due. Within the other consumer loan portfolio, closed-end loans are charged off when payments are 120 days in arrears, except small personal loans. Open-end (revolving credit) consumer loans, including credit card loans, and small personal loans are charged off when payments are 180 days in arrears. On a quarterly basis, residential mortgage loans that are 180 days delinquent and have an original loan-to-value ratio that is higher than 60% are reviewed and charged-off, as needed, to the fair value of the underlying collateral. Generally, all loans may be charged off or written down to the fair value of the collateral prior to the application of the policies described above if a loss-confirming event has occurred. Loss-confirming events include, but are not limited to, bankruptcy (unsecured), continued delinquency, or receipt of an asset valuation indicating a collateral deficiency when the asset is the sole source of repayment. The Corporation does not record charge-offs on PCI loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair value of these loans already reflects a credit component. The Corporation records charge-offs on PCI loans only if actual losses exceed estimated losses incorporated into the fair value recorded at acquisition and the amount is deemed uncollectible.

Other-than-temporary impairments (“OTTI”)

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered an OTTI. A security is considered impaired if the fair value is less than its amortized cost basis. The Corporation employs a systematic methodology that considers all available evidence in evaluating a potential impairment of its investments.

The impairment analysis of debt securities places special emphasis on the analysis of the cash position of the issuer and its cash and capital generation capacity, which could increase or diminish the issuer’s ability to repay its bond obligations, the length of time and the extent to which the fair value has been less than the amortized cost basis, any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the financial condition of the issuer, credit ratings, the failure of the issuer to make scheduled principal or interest payments, recent legislation and government actions affecting the issuer’s industry, and actions taken by the issuer to deal with the economic climate. The Corporation also takes into consideration changes in the near-term prospects of the underlying collateral of a security, if any, such as changes in default rates, loss severity given default, and significant changes in prepayment assumptions and the level of cash flows generated from the underlying collateral, if any, supporting the principal and interest payments of the debt securities. OTTI must be recognized in earnings if the Corporation 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 the Corporation does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred. An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. For available-for-sale and held-to-maturity debt securities the Corporations intends to hold, the credit loss component of an OTTI, if any, is recorded as net impairment losses on debt securities in the statements of income, while the remaining portion of the impairment loss is recognized in OCI, net of taxes, and included as a component of stockholders’ equity. The previous amortized cost basis less the OTTI recognized in earnings is the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value. Subsequent increases and decreases (if not an OTTI) in the fair value of available-for-sale securities is included in other comprehensive income. For held-to-maturity debt securities, any OTTI recognized in OCI should be accreted from other comprehensive income to the amortized cost of the debt security over the remaining life of the debt security. However, for debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income as long as the security is not placed in nonaccrual status. Debt securities held by the Corporation at year-end primarily consisted of securities issued by U.S. government-sponsored entities, private label mortgage-backed securities ("MBS"), certain bonds issued by the Puerto Rico Housing Finance Authority, a government instrumentality of the Commonwealth of Puerto Rico, and obligations of certain municipalities in Puerto Rico. Given the explicit and implicit guarantees provided by the U.S. federal government, the Corporation believes the credit risk in securities issued by the U.S. government-sponsored entities is low. The Corporation's OTTI assessment was concentrated on Puerto Rico government debt securities and private label MBS. For further information, including methodology and assumptions used for the discounted cash flow analyses performed on these securities, refer to Note 5 – Investment Securities, to the consolidated financial statements included in Item 8 of this Form 10-K.

Income Taxes

The Corporation is required to estimate income taxes in preparing its consolidated financial statements. This involves the estimation of current income tax expense together with an assessment of temporary differences resulting from differences in the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The determination of current income tax expense involves estimates and assumptions that require the Corporation to assume certain positions based on its interpretation of current tax regulations. Management assesses the relative benefits and risks of the appropriate tax treatment of transactions, taking into account statutory, judicial and regulatory guidance, and recognizes tax benefits only when deemed probable. Changes in assumptions affecting estimates may be required in the future and estimated tax liabilities may need to be increased or decreased accordingly. The accrual of tax contingencies is adjusted in light of changing facts and circumstances, such as the progress of tax audits, case law and emerging legislation. The Corporation's effective tax rate includes the impact of tax contingencies and changes to such accruals, as considered appropriate by management. When particular tax matters arise, a number of years may elapse before such matters are audited by the taxing authorities and finally resolved. Favorable resolution of such matters or the expiration of the statute of limitations may result in the release of tax contingencies that are recognized as a reduction to the Corporation's effective tax rate in the year of resolution. Unfavorable settlement of any particular issue could increase the effective tax rate and may require the use of cash in the year of resolution.

Income tax expense includes Puerto Rico and USVI 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. and USVI income tax purposes and, accordingly, is generally subject to U.S. and USVI income tax only on its income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those jurisdictions. Any such tax paid in the U.S. and USVI is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the 2011 PR Code, the Corporation and its subsidiaries are treated as separate taxable entities and are generally not entitled to file consolidated tax returns. Thus, the Corporation is generally not entitled to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from an NOL, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry-forward period. Pursuant to the 2011 PR Code, the carryforward period for NOLs incurred during taxable years that commenced after December 31, 2004 and ended before January 1, 2013 is 12 years; for NOLs incurred during taxable years commencing after December 31, 2012 the carryover period is 10 years. The 2011 PR Code allows an entity organized as a limited liability company to elect to become a non-taxable “pass-through” entity and utilize losses to offset income from other “pass-through” entities, subject to certain limitations, with the remaining net income passing-through to its partner entities. The 2011 PR Code also provides a dividend received deduction of 100% on dividends received from “controlled” subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

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

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Corporation’s net deferred tax asset assumes that the Corporation will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change, the Corporation may be required to record valuation allowances against its deferred tax assets, resulting in additional income tax expense in the consolidated statements of income. Management evaluates its deferred tax assets on a quarterly basis and assesses the need for a valuation allowance, if any. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in the valuation allowance from period to period are included in the Corporation's tax provision in the period of change.

After completion of the deferred tax asset valuation allowance analysis for the fourth quarter of 2018, management concluded that, as of December 31, 2018, it is more likely than not that FirstBank will generate sufficient taxable income within the applicable NOL carry-forward periods to realize $220.5 million of its deferred tax assets related to NOLs and, therefore, reversed $63.2 million of the valuation allowance. The decision to partially reverse the valuation allowance was reached after weighting all of the evidence and determining that the positive evidence out-weighted the negative evidence. The positive evidence considered by management in arriving at its decision to reverse part of the deferred tax asset valuation allowance includes factors such as: FirstBank's three-year cumulative income position; sustained periods of profitability following the hurricane events in 2017; and, forecasts of future profitability, under several potential scenarios, that support significant utilization of NOLs prior to their expiration ranging between the years 2021 through 2024. The negative evidence considered by management includes: uncertainties around the state of the Puerto Rico economy, including the effect of hurricane recovery funds together with Puerto Rico government debt renegotiation efforts and the ultimate sustainability of the approved Fiscal Plan; and consideration of the Corporation's still elevated levels of non-performing assets.

The authoritative accounting guidance prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under this guidance, income tax benefits are recognized and measured based on a two-step analysis: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized; and 2) the benefit is measured at the largest dollar amount of the position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this analysis and the tax benefit claimed on a tax return is referred to as an Unrecognized Tax Benefit ("UTB"). The Corporation classifies interest and penalties, if any, related to UTBs as components of income tax expense. As of December 31, 2018 and 2017, the Corporation did not have any UTBs recorded on its books.

Refer to Note 26 - Income Taxes, to the consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K for further information related to Income Taxes.

Classification and Related Values of Investment Securities

Management determines the appropriate classification of debt securities at the time of purchase. Debt securities are classified as held to maturity when the Corporation has the intent and ability to hold the securities to maturity. Held-to-maturity ("HTM") securities are stated at amortized cost. Debt securities are classified as trading when the Corporation has the intent to sell the securities in the near term. Debt classified as trading securities, if any, are reported at fair value, with unrealized gains and losses included in earnings. Debt securities not classified as HTM or trading are classified as available for sale (“AFS”). AFS securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported net of deferred taxes in accumulated OCI (a component of stockholders’ equity), and do not affect earnings until realized or are deemed to be other-than-temporarily impaired. New accounting guidance with respect to the accounting for equity securities effective beginning on January 1, 2018 requires the measurement of equity investments at fair value through net income, with certain exceptions, thus, eliminating eligibility for the available-for-sale category. Investments in equity securities that do not have publicly or readily determinable fair values are classified as equity securities in the statement of financial condition and carried at the lower of cost or realizable value. The assessment of fair value applies to certain of the Corporation’s assets and liabilities, including the investment portfolio. Fair values are volatile and are affected by factors such as market interest rates, the rates at which prepayments occur and discount rates.

Valuation of financial instruments

The measurement of fair value is fundamental to the Corporation’s presentation of its financial condition and results of operations. The Corporation holds fixed income and equity securities, derivatives, investments, and other financial instruments at fair value. The Corporation holds its investments and liabilities mainly to manage liquidity needs and interest rate risks. A significant part of the Corporation’s total assets is reflected at fair value on the Corporation’s financial statements.

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis:

Investment securities available for sale

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

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the U.S.; the interest rate on the securities is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread based on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions such as the prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (*i.e.*, loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, and others) in combination with prepayment forecasts based on historical portfolio performance. 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, using an asset-level risk assessment method taking into account loan credit characteristics (loan-to-value, state jurisdiction, delinquency, property type and pricing behavior, and other factors) to provide an estimate of default and loss severity.

Derivative instruments

The fair value of most of the Corporation's derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties, when appropriate. On interest caps, only the seller's credit risk is considered. The caps were valued using a discounted cash flow approach based on the related LIBOR and swap rate for each cash flow.

A credit spread is considered for those derivative instruments that are not secured. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments in 2018, 2017 and 2016 was immaterial.

Income Recognition on Loans and Impaired Loans

Loans that the Corporation has the ability and intent to hold for the foreseeable future are classified as held for investment. The substantial majority of the Corporation's loans are classified as held for investment. Loans are stated at the principal outstanding balance, net of unearned interest, cumulative charge-offs, unamortized deferred origination fees and costs, and unamortized premiums and discounts. Fees collected and costs incurred in the origination of new loans are deferred and amortized using the interest method or a method that approximates the interest method over the term of the loan as an adjustment to interest yield. Unearned interest on certain personal loans, auto loans and finance leases and discounts and premiums are recognized as income under a method that approximates the interest method. When a loan is paid-off or sold, any unamortized net deferred fee (cost) is credited (charged) to income. Credit card loans are reported at their outstanding unpaid principal balance plus uncollected billed interest and fees net of amounts deemed uncollectible. PCI loans are reported net of any remaining purchase accounting adjustments. See "Loans Acquired" below for the accounting policy for PCI loans.

Nonaccrual and Past-Due Loans **-** Loans on which the recognition of interest income has been discontinued are designated as nonaccrual. Loans are classified as nonaccrual when they are 90 days past due for interest and principal, with the exception of residential mortgage loans guaranteed by the Federal Housing Administration (the "FHA") or the Veterans Administration (the "VA") and credit cards. It is the Corporation's policy to report delinquent mortgage loans insured by the FHA, or guaranteed by the VA or the Puerto Rico Housing Finance Authority, as loans past due 90 days and still accruing as opposed to nonaccrual loans since the principal repayment is insured. However, the Corporation discontinues the recognition of income for FHA/VA loans when such loans are over 15 months delinquent, taking into consideration the FHA interest curtailment process, and for loans guaranteed by the Puerto Rico Housing Finance Authority when such loans are over 90 days delinquent. As permitted by regulatory guidance issued by the Federal Financial Institutions Examination Council ("FFIEC"), credit card loans are generally charged off in the period in which the account becomes 180 days past due. Credit card loans continue to accrue finance charges and fees until charged off at 180 days. Loans generally may be placed on nonaccrual status prior to when required by the policies described above when the full and timely collection of interest or principal becomes uncertain (generally based on an assessment of the borrower's financial condition and the adequacy of collateral, if any). When a loan is placed on nonaccrual status, any accrued but uncollected interest income is reversed and charged against interest income and amortization of any net deferred fees is suspended. Interest income on nonaccrual loans is recognized only to the extent it is received in cash. However, when there is doubt regarding the ultimate collectability of loan principal, all cash thereafter received is applied to reduce the carrying value of such loans (*i.e.*, the cost recovery method). Generally, the Corporation returns a loan to accrual status when all delinquent interest and principal becomes current under the terms of the loan agreement, or after a sustained period of repayment performance (6 months) and the loan is well secured and in the process of collection, and full repayment of the remaining contractual principal and interest is expected. PCI loans are not reported as nonaccrual as these loans were written down to fair value at the acquisition date and the accretable yield is recognized in interest income over the remaining life of the loans. Loans that are past due 30 days or more as to principal or interest are considered delinquent, with the exception of residential mortgage, commercial mortgage, and construction loans, which are considered past due when the borrower is in arrears on two or more monthly payments.

Impaired Loans **-** A loan is considered impaired when, based upon current information and events, it is probable that the Corporation will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the loan agreement, or the loan has been modified in a Troubled Debt Restructuring ("TDR"). Loans with insignificant delays or insignificant shortfalls in the amounts of payments expected to be collected are not considered to be impaired. The Corporation evaluates individually for impairment those loans in the construction, commercial mortgage, and commercial and industrial portfolios of $1 million or more as well as any boat loan of $1 million or more. Although the authoritative accounting guidance for a specific impairment of a loan excludes large groups of smaller balance homogeneous loans that are collectively evaluated for impairment (*e.g.*, mortgage and consumer loans), it specifically requires that loan modifications considered TDRs be analyzed under its provision. The Corporation also evaluates for impairment purposes certain residential mortgage loans and home equity lines of credit with high delinquency and loan to value levels. Held-for-sale loans are not reported as impaired, as these loans are recorded at the lower of cost or fair value.

The Corporation generally measures impairment and the related specific allowance for individually impaired loans based on the difference between the recorded investment of the loan and the present value of the loans' expected future cash flows, discounted at the effective original interest rate of the loan at the time of modification, or the loan's observable market price. If the loan is collateral dependent, the Corporation measures impairment based upon the fair value of the underlying collateral, instead of discounted cash flows, regardless of whether foreclosure is probable. Loans are identified as collateral dependent if the repayment is expected to be provided solely by the underlying collateral, through liquidation or operation of the collateral. When the fair value of the collateral is used to measure impairment on an impaired collateral-dependent loan and repayment or satisfaction of the loan is dependent on the sale of the collateral, the fair value of the collateral is adjusted to consider estimated costs to sell. If repayment is dependent only on the operation of the collateral, the fair value of the collateral is not adjusted for estimated costs to sell. If the fair value of the loan is less than the recorded investment, the Corporation recognizes impairment by either a direct write-down or establishing a specific allowance for the loan or by adjusting the specific allowance for the impaired loan. For an impaired loan that is collateral dependent, charge-offs are taken in the period in which the loan, or a portion of the loan, is deemed uncollectible, and any portion of the loan that is not charged off is adversely credit-risk rated at a level no worse than substandard.

A restructuring of a loan constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. TDR loans typically result from the Corporation's loss mitigation activities and the modification of residential mortgage loans in accordance with guidelines similar to those of the U.S. government's Home Affordable Modification Program, and could include rate reductions to a rate that is below market on the loan, principal forgiveness, term extensions, payment forbearance, refinancing of any past-due amounts, including interest, escrow, and late charges and fees, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. Residential mortgage loans for which a binding offer to restructure has been extended are also classified as TDR loans. PCI loans are not classified as TDR loans.

TDR loans are classified as either accrual or nonaccrual loans. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loans had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, loans on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments, can, and are likely to, continue as agreed. Refer to Note 8 – Loans Held for Investment, to the consolidated financial statements for the year ended December 31, 2018, included in Item 8 of this Form 10-K for additional qualitative and quantitative information about TDR loans.

In connection with commercial loan restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well-documented credit evaluation of the borrower’s financial condition and prospects for repayment under the modified terms. The credit evaluation reflects consideration of the borrower’s future capacity to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectability of receivables. This evaluation also includes an evaluation of the borrower’s current willingness to pay, which may include a review of past payment history, an evaluation of the borrower’s willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support.

The evaluation of mortgage and consumer loans for restructurings includes an evaluation of the client's disposable income and credit report, the value of the property, the loan-to-value relationship, and certain other client-specific factors that have affected the borrower's ability to make timely principal and interest payments on the loan.

The Corporation removes loans from TDR classification, consistent with authoritative guidance that allows for a TDR to be removed from this classification in years following the modification, only when the following two circumstances are met:

- The loan is in compliance with the terms of the restructuring agreement and, therefore, is not considered impaired under the revised terms; and

- The loan yields a market interest rate at the time of the restructuring. In other words, the loan was restructured with an interest rate equal to or greater than what the Corporation would have been willing to accept at the time of the restructuring for a new loan with comparable risk.

If both of the conditions are met, the loan can be removed from the TDR classification in calendar years after the year in which the restructuring took place. However, the loan continues to be individually evaluated for impairment. Loans classified as TDRs, including loans in trial payment periods (trial modifications), are considered impaired loans.

With respect to the restructuring of a loan into two new loan notes, or loan splits, generally, Note A of a loan split is restructured under market terms, and Note B is fully charged off. If Note A is in compliance with the restructured terms in years following the restructuring, Note A will be removed from the TDR classification and will continue to be individually evaluated for impairment.

A loan that had previously been modified in a TDR and is subsequently refinanced under current underwriting standards at a market rate with no concessionary terms is accounted for as a new loan and is no longer reported as a TDR.

Interest income on impaired loans is recognized based on the Corporation's policy for recognizing interest on accrual and nonaccrual loans.

Loans Acquired

All purchased loans are recorded at fair value at the date of acquisition. Loans acquired with evidence of credit deterioration since their origination and where it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments are considered PCI loans. Evidence of credit quality deterioration as of the purchase date may include statistics such as past due and nonaccrual status, credit scores, and revised loan terms. PCI loans have been aggregated into pools based on common risk characteristics. Each pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. In accounting for PCI loans, the difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. The nonaccretable difference, which is neither accreted into income nor recorded on the consolidated statements of financial condition, reflects estimated future credit losses expected to be incurred over the life of the pool of loans. The excess of cash flows expected to be collected over the estimated fair value of PCI loans is referred to as the accretable yield. This amount is not recorded on the statements of financial condition, but is accreted into interest income over the remaining life of the pool of loans, using the effective-yield method.

Subsequent to acquisition, the Corporation continues to estimate cash flows expected to be collected over the life of the PCI loans using models that incorporate current key assumptions such as default rates, loss severity, and prepayment speeds. Decreases in expected cash flows will generally result in an impairment charge to the provision for loan and lease losses and the establishment of an allowance for loan and lease losses. Increases in expected cash flows will generally result in a reduction in any allowance for loan and lease losses established subsequent to acquisition and an increase in the accretable yield. The adjusted accretable yield is recognized in interest income over the remaining life of the pool of loans.

Resolutions of loans may include sales of loans to third parties, receipt of payments in settlement with the borrower, or foreclosure of the collateral. The Corporation’s policy is to remove an individual loan from a pool at its relative carrying amount. The carrying amount is defined as the loan’s current contractually required payments receivable less its remaining nonaccretable difference and accretable yield, but excluding any post-acquisition loan loss allowance. To determine the carrying value, the Corporation performs a pro-rata allocation of the pool’s total remaining nonaccretable difference and accretable yield to an individual loan in proportion to the loan’s current contractually required payments receivable compared to the pool’s total contractually required payments receivable. This removal method assumes that the amount received from resolution approximates pool performance expectations. The remaining accretable yield balance is unaffected and any material change in the remaining effective yield caused by this removal method is addressed by the Corporation’s quarterly cash flow evaluation process for each pool. Modified PCI loans are not removed from a pool even if those loans would otherwise be deemed TDRs.

Because the initial fair value of PCI loans recorded at acquisition includes an estimate of credit losses expected to be realized over the remaining lives of the loans, the Corporation separately tracks and reports PCI loans and excludes these loans from its delinquency and nonaccrual loan statistics.

For acquired loans that are not deemed impaired at acquisition, subsequent to acquisition, the Corporation recognizes the difference between the initial fair value at acquisition and the undiscounted expected cash flows in interest income over the period in which substantially all of the inherent losses associated with the non-PCI loans at the acquisition date are estimated to occur. Thus, such loans are accounted for consistently with other originated loans, potentially being classified as nonaccrual or impaired, as well as being classified under the Corporation's standard practice and procedures. In addition, these loans are considered in the determination of the allowance for loan losses.

Loans held for sale

Loans that the Corporation intends to sell or that the Corporation does not have the ability and intent to hold for the foreseeable future are classified as held-for-sale loans. Loans held for sale are stated at the lower of aggregate cost or fair value. Generally, the loans held-for-sale portfolio consists of conforming residential mortgage loans that the Corporation intends to sell to GNMA and government-sponsored entities ("GSEs"), such as the FNMA and FHLMC. Generally, residential mortgage loans held for sale are valued on an aggregate portfolio basis and the value is primarily derived from quotations based on the mortgage-backed securities market. The amount by which cost exceeds market value in the aggregate portfolio of loans held for sale, if any, is accounted for as a valuation allowance with changes therein included in the determination of net income and reported as part of mortgage banking activities in the consolidated statements of income. Loan costs and fees are deferred at origination and are recognized in income at the time of sale. The fair value of commercial and construction loans held for sale is primarily derived from external appraisals, or broker price opinions that the Corporation considered, with changes in the valuation allowance reported as part of other non-interest income in the consolidated statements of income.

In certain circumstances, the Corporation transfers loans from/to held for sale or held for investment based on a change in strategy. If such a change in holding strategy is made, significant adjustments to the loans' carrying values may be necessary. Reclassifications of loans held for investment to held for sale are made at the lower of cost or fair value on the date of transfer and establish a new cost basis upon transfer. Write-downs of loans transferred from held for investment to held for sale are recorded as charge-offs at the time of transfer. Subsequent changes in value below amortized cost are recorded through non-interest income. Reclassifications of loans held for sale to held for investment are made at fair value on the date of transfer. Any difference between the carrying value and the fair value of a reclassified loan is recorded as an adjustment to non-interest income, prospectively, over the remaining life of the loan.

Results of Operations

Net Interest Income

Net interest income is the excess of interest earned by First BanCorp. on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp.'s net interest income is subject to interest rate risk due to the repricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the year ended December 31, 2018 was $525.4 million, compared to $491.6 million and $484.1 million for 2017 and 2016, respectively. On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments, net interest income for the year ended December 31, 2018 was $546.9 million compared to $508.0 million and $497.4 million for 2017 and 2016, respectively.

The following tables include a detailed analysis of net interest income. Part I presents average volumes (based on the average daily balance) 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 the 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 in (i) volume (changes in volume multiplied by prior period rates), and (ii) rate (changes in rate multiplied by prior period volumes). Rate-volume variances (changes in rate multiplied by changes in volume) have been allocated to the changes in volume and rate based upon their respective percentage of the combined totals.

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

Part I

Year Ended December 31, (Dollars in thousands)	**Average volume**			**Interest income(1) / expense**			**Average rate(1)**		
	2018	**2017**	**2016**	**2018**	**2017**	**2016**	**2018**	**2017**	**2016**
Interest-earning assets:									
Money market and other short-term investments	$ 623,892	$ 416,578	$ 667,838	$ 11,120	$ 4,614	$ 3,365	1.78%	1.11%	0.50%
Government obligations (2)	799,358	687,076	746,890	28,044	17,918	20,849	3.51%	2.61%	2.79%
Mortgage-backed securities	1,347,979	1,278,968	1,357,518	45,311	42,476	38,072	3.36%	3.32%	2.80%
FHLB stock	40,389	40,458	31,449	2,728	2,105	1,454	6.75%	5.20%	4.62%
Other investments	2,881	2,702	1,963	15	8	8	0.52%	0.30%	0.41%
Total investments (3)	2,814,499	2,425,782	2,805,658	87,218	67,121	63,748	3.10%	2.77%	2.27%
Residential mortgage loans	3,179,487	3,260,715	3,302,519	170,751	174,524	180,051	5.37%	5.35%	5.45%
Construction loans	117,993	140,038	143,095	4,729	4,898	5,225	4.01%	3.50%	3.65%
Commercial and Industrial and Commercial mortgage loans	3,629,329	3,723,356	3,694,988	192,632	174,666	160,329	5.31%	4.69%	4.34%
Finance leases	287,400	242,303	229,632	21,126	17,538	17,349	7.35%	7.24%	7.56%

Consumer loans	1,512,984	1,480,265	1,526,475	169,978	166,107	171,858	11.23%	11.22%	11.26%
Total loans (4)(5)	8,727,193	8,846,677	8,896,709	559,216	537,733	534,812	6.41%	6.08%	6.01%
Total interest-earning assets	$ 11,541,692	$ 11,272,459	$ 11,702,367	$ 646,434	$ 604,854	$ 598,560	5.60%	5.37%	5.11%
Interest-bearing liabilities:									
Interest-bearing checking accounts	$ 1,288,240	$ 1,116,273	$ 1,073,821	$ 5,208	$ 4,566	$ 4,914	0.40%	0.41%	0.46%
Savings accounts	2,364,774	2,394,708	2,503,047	14,298	12,520	12,392	0.60%	0.52%	0.50%
Certificates of deposit	2,404,764	2,397,443	2,367,874	33,652	30,277	28,068	1.40%	1.26%	1.19%
Brokered CDs	816,229	1,296,479	1,805,443	14,493	19,174	21,928	1.78%	1.48%	1.21%
Interest-bearing deposits	6,874,007	7,204,903	7,750,185	67,651	66,537	67,302	0.98%	0.92%	0.87%
Other borrowed funds	352,729	514,035	833,283	18,384	19,195	27,908	5.21%	3.73%	3.35%
FHLB advances	705,000	680,975	460,861	13,549	11,140	5,964	1.92%	1.64%	1.29%
Total interest-bearing liabilities	$ 7,931,736	$ 8,399,913	$ 9,044,329	$ 99,584	$ 96,872	$ 101,174	1.26%	1.15%	1.12%
Net interest income				$ 546,850	$ 507,982	$ 497,386			
Interest rate spread							4.34%	4.22%	3.99%
Net interest margin							4.74%	4.51%	4.25%

(1) On an adjusted tax-equivalent basis. The adjusted tax-equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate of 39.0% and adding to it the cost of interest-bearing liabilities. The tax-equivalent adjustment recognizes the income tax savings when comparing taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. Therefore, management believes these measures provide useful information to investors by allowing them to make peer comparisons. Changes in the fair value of derivatives are excluded from interest income and interest expense because the changes in valuation do not affect interest received or paid.

(2) Government obligations include debt issued by government-sponsored agencies.

(3) Unrealized gains and losses on available-for-sale securities are excluded from the average volumes.
(4) Average loan balances include the average of nonaccrual loans.
(5) Interest income on loans includes $7.7 million, $6.7 million and $9.9 million for 2018, 2017 and 2016, respectively, of income from prepayment penalties and late fees related to the Corporation's loan portfolio.

Part II

	2018 Compared to 2017 Increase (decrease) Due to:			2017 Compared to 2016 Increase (decrease) Due to:		
	Volume	Rate	Total	Volume	Rate	Total
(In thousands)						
Interest income on interest-earning assets:						
Money market and other short-term investments	$ 2,925	$ 3,581	$ 6,506	$ (2,024)	$ 3,273	$ 1,249
Government obligations	3,253	6,873	10,126	(1,609)	(1,322)	(2,931)
Mortgage-backed securities	2,315	520	2,835	(2,406)	6,810	4,404
FHLB stock	(4)	627	623	453	198	651
Other investments	1	6	7	3	(3)	-
Total investments	8,490	11,607	20,097	(5,583)	8,956	3,373
Residential mortgage loans	(4,355)	582	(3,773)	(2,262)	(3,265)	(5,527)
Construction loans	(827)	658	(169)	(110)	(217)	(327)
Commercial and Industrial and Commercial mortgage loans	(4,701)	22,667	17,966	1,240	13,097	14,337
Finance leases	3,311	277	3,588	937	(748)	189
Consumer loans	3,676	195	3,871	(5,187)	(564)	(5,751)
Total loans	(2,896)	24,379	21,483	(5,382)	8,303	2,921
Total interest income	$ 5,594	$ 35,986	$ 41,580	$ (10,965)	$ 17,259	$ 6,294
Interest expense on interest-bearing liabilities:						
Brokered CDs	$ (7,815)	$ 3,134	$ (4,681)	$ (6,854)	$ 4,100	$ (2,754)
Other interest-bearing deposits	1,221	4,574	5,795	(284)	2,273	1,989
Other borrowed funds	(7,215)	6,404	(811)	(11,307)	2,594	(8,713)
FHLB advances	405	2,004	2,409	3,333	1,843	5,176
Total interest expense	(13,404)	16,116	2,712	(15,112)	10,810	(4,302)
Change in net interest income	$ 18,998	$ 19,870	$ 38,868	$ 4,147	$ 6,449	$ 10,596

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

The presentation of net interest income excluding the effects of the changes in the fair value of the derivative instruments (“valuations”) provides additional information about the Corporation’s net interest income and facilitates comparability and analysis. The changes in the fair value of the derivative instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively.

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

	Year Ended December 31,		
	2018	**2017**	**2016**
(Dollars in thousands)			
Interest income - GAAP	$ 624,967	$ 588,423	$ 585,29
Unrealized (gain) loss on derivative instruments	(22)	2	
Interest income excluding valuations	624,945	588,425	585,29
Tax-equivalent adjustment	21,489	16,429	13,26
Interest income on a tax-equivalent basis excluding valuations	646,434	604,854	598,56
Interest expense - GAAP	99,584	96,872	101,17
Net interest income - GAAP	$ 525,383	$ 491,551	$ 484,11
Net interest income excluding valuations - Non-GAAP	$ 525,361	$ 491,553	$ 484,11
Net interest income on a tax-equivalent basis and excluding valuations - Non-GAAP	$ 546,850	$ 507,982	$ 497,38
Average Balances			
Loans and leases	$ 8,727,193	$ 8,846,677	$ 8,896,70
Total securities, other short-term investments and interest-bearing cash balances	2,814,499	2,425,782	2,805,65
Average interest-earning assets	$ 11,541,692	$ 11,272,459	$ 11,702,36
Average interest-bearing liabilities	$ 7,931,736	$ 8,399,913	$ 9,044,32
Average Yield/Rate			
Average yield on interest-earning assets - GAAP	5.41%	5.22%	5.00%
Average rate on interest-bearing liabilities - GAAP	1.26%	1.15%	1.12%
Net interest spread - GAAP	4.15%	4.07%	3.88%
Net interest margin - GAAP	4.55%	4.36%	4.14%
Average yield on interest-earning assets excluding valuations - Non-GAAP	5.41%	5.22%	5.00%
Average rate on interest-bearing liabilities	1.26%	1.15%	1.12%
Net interest spread excluding valuations - Non-GAAP	4.15%	4.07%	3.88%
Net interest margin excluding valuations - Non-GAAP	4.55%	4.36%	4.14%
Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations - Non-GAAP	5.60%	5.37%	5.11%
Average rate on interest-bearing liabilities	1.26%	1.15%	1.12%
Net interest spread on a tax-equivalent basis and excluding valuations - Non-GAAP	4.34%	4.22%	3.99%
Net interest margin on a tax-equivalent basis and excluding valuations - Non-GAAP	4.74%	4.51%	4.25%

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

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

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

2018 compared to 2017

Net interest income for the year ended December 31, 2018 amounted to $525.4 million, an increase of $33.8 million, when compared to $491.6 million in 2017. The $33.8 million increase in net interest income was primarily due to:

- A $17.2 million increase in interest income on commercial and construction loans, primarily related to the upward repricing of variable-rate commercial loans and higher yields on new loan originations.

- A $9.1 million increase in interest income on investment securities, primarily due to the gradual reinvestment of liquidity, obtained from the growth in non-interest bearing deposits and proceeds from maturing debt securities into higher-yielding U.S. agencies debt securities and MBS. The average balance of investment securities for 2018 increased by $181.4 million compared to 2017.

- A $7.5 million increase in interest income on consumer loans, mainly due to a $77.8 million increase in the average balance of this portfolio, primarily auto loans and finance leases. The variance includes a $1.0 million increase in late payment fees as the Corporation did not assess late charges during the fourth quarter of 2017 to customers affected by Hurricanes Irma and Maria that qualified for the three-month payment deferral program established by the Corporation after the hurricanes.

- A $6.5 million increase in interest income from interest-bearing cash balances due to both an increase of $207.3 million in the average balance, primarily deposits maintained at the Federal Reserve Bank of New York, and increases in the Federal Funds Target Rate. A growth in non-interest bearing deposits provided higher liquidity levels in 2018. The Federal Funds target rate has increased four times since the end of 2017 from a range of 1.25% - 1.50% to its current range of 2.25% - 2.50%.

Partially offset by:

- A $3.7 million decrease in interest income on residential mortgage loans, primarily related to an $81.2 million decline in the average balance of this portfolio. Approximately 71% of the residential mortgage loan originations in Puerto Rico consisted of conforming loan originations sold in the secondary market to GNMA and GSEs.

- A $2.7 million increase in total interest expense, driven by: (i) a $5.8 million increase in interest expense on non-brokered interest-bearing deposits, driven by the effect of higher market interest rates on the cost of retail CDs and commercial money market accounts tied to variable short-term interest rates; (ii) a $2.4 million increase in interest expense on FHLB advances reflecting increased use of long-term advances to fund its lending and investment activities; and (iii) a $0.7 million increase in interest expense related to the upward repricing of floating-rate junior subordinated debentures. The aforementioned increases were partially offset by a $4.7 million decrease in interest expense on brokered CDs, primarily related to a $480.3 million decrease in the average balance that offset higher costs of new issuances, and a $1.5 million decrease in interest expense on repurchase agreements related to a $134.0 million decrease in the average balance. During 2018, the Corporation repaid $657.9 million of maturing brokered CDs with an all-in cost of 1.45% and new issuances amounted to $62.0 million with an all-in cost of 2.95%.

The net interest margin increased by 19 basis points to 4.55% for 2018, compared to 4.36% for 2017, driven by the aforementioned upward repricing of commercial and construction loans, an improved funding mix, driven by the increase in the proportion of interest-earning assets funded by the growth in non-interest bearing deposits, and the gradual reinvestment of liquidity in higher-yielding securities.

On an adjusted tax-equivalent basis, net interest income for the year ended December 31, 2018 increased by $38.9 million to $546.9 million, when compared to 2017. In addition to the facts discussed above, the tax equivalent adjustment increased by $5.1 million, primarily related to the increase in interest income from tax-exempt U.S. agencies debt and MBS held by the IBE subsidiary First Bank Overseas.

2017 compared to 2016

Net interest income for the year ended December 31, 2017 amounted to $491.6 million, an increase of $7.4 million, when compared to $484.1 million in 2016. The $7.4 million increase in net interest income was primarily due to:

- A $12.5 million increase in interest income on commercial and construction loans, primarily related to both the upward repricing of variable-rate commercial loans and the growth of the performing commercial portfolios, primarily in the Florida region.

- A $4.3 million decrease in interest expense, driven by: (i) a $9.3 million decrease in interest expense on repurchase agreements, primarily reflecting the full-year effect of the repayments of repurchase agreements totaling $400 million that matured during the third and fourth quarters of 2016 and carried an average cost of 3.35%; and (ii) a $ 2.8 million decrease in interest expense on brokered CDs, primarily related to a $509.0 million decrease in the average volume that offset higher costs on new issuances. During 2017, the Corporation repaid $803.6 million of maturing brokered CDs with an all-in cost of 1.12% and new issuances amounted to $514.0 million with an all-in cost of 1.70%.

The aforementioned variances were partially offset by: (i) a $5.2 million increase in interest expense on FHLB advances, reflecting the increases in the proportion of long-term and short-term FHLB advances used to fund lending activities and the effect of higher market interest rates; (ii) an increase of $2.0 million in interest expense on non-brokered interest-bearing deposits reflecting, among other things, a higher proportion of time deposits to total deposits, the renewal of retail CDs at longer terms, and higher market interest rates in 2017; and (iii) an increase of $0.6 million in interest expense related to the upward repricing of floating-rate junior subordinated debentures.

- A $1.2 million increase in interest income from deposits maintained at the Federal Reserve Bank due to increases in the Federal Funds' target rate in 2017 and late in 2016.

- A $0.2 million increase in interest income on investment securities, driven by a $2.1 million increase in interest income on U.S. agency MBS, primarily due to a lower premium amortization expense resulting from lower prepayment rates in 2017, and a $0.7 million increase in FHLB dividend income. These variances were partially offset by an adverse impact of approximately $1.7 million related to the aforementioned bonds of the GDB and the Puerto Rico Public Buildings Authority for which recognition of interest income was discontinued during the third quarter of 2016, and the effect in 2016 of discount accretions totaling $0.8 million related to $72.4 million of U.S. agencies debt securities called prior to maturity.

Partially offset by:

- A $5.6 million decrease in interest income on consumer loans and finance leases, mainly attributable to the decrease of $33.5 million in the average balance of this portfolio, primarily auto loans, and, to a lesser extent, the effect of a $1.4 million decrease in late payment fees, as the Corporation did not assess late charges during the fourth quarter of 2017 to customers affected by Hurricanes Irma and Maria that qualified for the three-month payment deferral program established by the Corporation after the hurricanes.

- A $5.3 million decrease in interest income on residential mortgage loans reflecting the effect of both a higher level of inflows of residential mortgage loans to non-performing status and a $41.8 million decrease in the average balance of this portfolio.

The net interest margin increased by 22 basis points to 4.36% for 2017, compared to 4.14% for 2016, driven by the aforementioned upward repricing of commercial and construction loans, the decrease in U.S. agency MBS premium amortization expense, and the benefit of the overall lower level of liquidity that reflects the effect of cash balances used for the repayment of high-cost repurchase agreements that matured during the second half of 2016.

On an adjusted tax-equivalent basis, net interest income for the year ended December 31, 2017 increased by $10.6 million to $508.0 million, when compared to 2016. In addition to the facts discussed above, the tax equivalent adjustment increased by $3.2 million during 2017, as compared to 2016, primarily in connection with the increase in interest income on U.S. agencies MBS held by the IBE subsidiary First Bank Overseas and higher income on tax-exempt commercial loans.

Provision 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 incurred 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. Important factors that influence this judgment are re-evaluated quarterly to respond to changing conditions.

As described in Note 2 – Effects of Natural Disasters, in the consolidated financial statements included in Item 8 of this Form 10-K, two strong hurricanes affected the Corporation's service areas during September 2017. These hurricanes caused widespread property damage, flooding, power outages, and water and communication service interruptions, and severely disrupted normal economic activity in the affected areas. During the third quarter of 2017, the Corporation recorded a $66.5 million charge to the provision related to the establishment of qualitative reserves associated with the effects of Hurricanes Irma and Maria. Initially, these qualitative reserves were derived from a regression modeling approach in which relationships between portfolio-level loss rates and key economic indicators were determined based on historical behavior. Accordingly, the qualitative reserves were initially determined in 2017 based on the estimated effect that the hurricanes could have on employment levels and economic activity in the Corporation's service areas, and the time that it could take for the affected regions to return to a more normalized operating environment.

During 2018, the Corporation performed additional procedures to evaluate the adequacy of the qualitative reserve, including the consideration of updated payment patterns and probability of default credit risk analyses applied to consumer loan borrowers subject to payment deferral programs that expired early in 2018. For the determination of the hurricane-related qualitative reserve for residential mortgage loans as of December 31, 2018, the Corporation stressed the loss factors derived from its base methodology by incorporating assumptions of deterioration in the current housing price index and higher loan modification levels. Although the foreclosure moratoriums extended by the FHA to hurricane-affected individuals ended on September 15, 2018, there are likely to be additional delays in foreclosures actions due to court-related backlogs. For the determination of the hurricane-related qualitative reserve for commercial and construction loans not individually reviewed as of December 31, 2018, the Corporation segregated the portfolio based on delinquency levels and stressed the general reserve loss factors applicable to 30-89 days past due loans to reflect higher default probabilities

For large commercial and construction loan relationships, loan officers performed individual reviews of the effect of the hurricanes on these borrowers' sources of repayment. These large relationships were analyzed and divided into three hurricane-affected categories (*i.e.* Low, Medium, and High). This stratification was used to stressed the general reserve loss factors applicable to these loans to reflect higher default probabilities not reflected in the historical data.

Relationship officers have continued to closely monitor the performance of hurricane-affected commercial loan customers during 2018. Information provided by these commercial loan officers, including information derived from regularly scheduled annual reviews, and statistics on the performance of consumer and residential credits, were factored into the determination of the allowance for loan and lease losses as of December 31, 2018. Although the identification and evaluation of hurricane-affected credits has been completed, management's assessment of the hurricanes' effect is still subject to uncertainties, both those specific to certain individual customers, such as the resolution of insurance claims, and those applicable to the overall economic prospects of the hurricane-affected areas as a whole.

As a result of the aforementioned analyses, the Corporation recorded in 2018 a net loan loss reserve release of $16.9 million in connection with revised estimates of the effects of the hurricanes, compared to charges to the provision of $71.3 million recorded in 2017. In addition to the above-mentioned updated assessments of financial performance and repayment prospects of certain individually-assessed commercial credits and updated payment patterns and probability of default credit risk analyses applied to consumer borrowers that were subject to payment deferral programs, the reserve releases in 2018 reflect the effect of payments received during the year that reduced the balance of consumer and residential mortgage loan portfolios outstanding on the dates of the hurricanes. In addition, during 2018, consumer loan charge-offs totaling $10.9 million were taken against previously-established hurricane-related qualitative reserves. These charge-offs were directly linked to the performance of consumer borrowers that were subject to payment deferral programs. As of December 31, 2018, the hurricane-related qualitative reserves amounted to $19.2 million (2017 - $55.6 million). On a portfolio basis, the hurricane-related qualitative reserve was composed of: (i) an $8.8 million hurricane-related qualitative reserve for residential mortgage loans (2017 - $9.2 million); (ii) a $7.2 million hurricane-related qualitative reserve for commercial and construction loans (2017 - $21.4 million); and (iii) a $3.2 million hurricane-related qualitative reserve for consumer loans (2017 - $25.0 million). As the Corporation acquires additional information on overall economic prospects in the storm-affected areas and the performance of consumer credits that had been under payment deferral programs and obtains further assessments of individual borrowers, the loss estimate will be revised as needed.

On a non-GAAP basis, excluding the aforementioned effects of reserve releases and charges associated with the hurricane-related qualitative reserves, the adjusted provision for loan and lease losses was $76.2 million for the year ended December 31, 2018, compared to $73.0 million and $86.7 million for 2017 and 2016, respectively.

2018 compared to 2017

On a non-GAAP basis, excluding the effects of reserve releases and charges associated with the hurricane-related qualitative reserves, the adjusted provision for loan and lease losses of $76.2 million for 2018 increased by $3.2 million as compared to the adjusted provision of $73.0 million for 2017. The $3.2 million increase in the adjusted provision was driven by:

- A $26.2 million increase in the adjusted provision for commercial and construction loans, primarily reflecting charges of $22.3 million recorded in 2018 related to developments in problem loans resolution strategies, including a $15.7 million charge to the provision related to fair value write-downs on $74.4 million of nonaccrual loans transferred to held for sale during 2018. During 2018, the Corporation transferred to held for sale several nonaccrual commercial and construction loans. The aggregate recorded investment in these loans of $96.6 million was written down to $74.4 million, which resulted in net charge-offs of $22.2 million, of which $6.5 million was taken against previously-established reserves for loan losses, resulting in the $15.7 million charge to the provision in 2018. Approximately $57.2 million of the $74.4 million nonaccrual loans transferred to held for held during 2018, were sold prior to the end of the year. In addition, the higher adjusted provision for commercial and construction loans reflects the effect of charges to the provision totaling $13.7 million associated with the downgrade in the credit risk classification of two large commercial relationships in 2018, partially offset by a $3.3 million increase in loan loss recoveries and a $1.6 million decrease related to the refinements to both the determination of historical loss rates and the measurement of qualitative factors used in the estimation process of the general reserve for commercial loans, as further discussed below.

Partially offset by:

- A $22.6 million decrease in the adjusted provision for residential loans, primarily reflecting declines in charge-offs, nonaccrual, and delinquent loan levels, the overall decrease in the size of this portfolio, and the effect in 2017 of adjustments to the loss severity estimates used in the calculation of the general reserve.

- A $0.4 million decrease in the adjusted provision for consumer loans, primarily reflecting lower charge-off levels (excluding the above-mentioned charge-offs of $10.9 million taken against previously-established hurricane qualitative reserves), partially offset by the increase in size of the auto and finance leases portfolio, the effect of refinements discussed below in the measurement of qualitative factors used in the determination of the general reserve of consumer loans implemented in the second quarter of 2018.

During the second quarter of 2018, and as part of the Corporation's plan to remediate a material weakness identified in the preparation of financial statements included in the 2017 Annual Report on Form 10-K, an independent third party engaged by the Corporation completed its assessment of the commercial allowance for loan losses framework and the appropriateness of assumptions used in the analysis. The Corporation reviewed the assessment and decided to implement certain enhancements, which include, among others, a revised procedure whereby historical loss rates for each commercial loan regulatory-based credit risk category (*i.e.*, pass, special mention, substandard, and doubtful) are now calculated using the historical charge-offs and portfolio balances over their average loss emergence period (the "raw loss rate") for each credit risk classification. However, when not enough loss experience is observed in a particular risk-rated category and the calculation results in a loss rate for such risk-rated category that is lower than the loss rate of a less severe risk-rated category, the Corporation now uses the loss rate of such less severe category.

As of March 31, 2018, the historical losses and portfolio balances of special mention loans were allocated to pass or substandard categories based on the historical proportion of loans in this risk category that ultimately cured or resulted in being uncollectible.

In addition, during the second quarter of 2018, the Corporation implemented refinements to the measurement of qualitative factors in the estimation process of the allowance for loan losses for commercial and consumer loans, primarily consisting of the incorporation of a basis point adjustment derived from the difference between the average raw loss rate and the highest loss rates observed during a look-back period that management determined was appropriate to use for each region to identify any relevant effect during an economic cycle.

Although the net effect of these refinements was immaterial to the total provision expense, on a portfolio basis these enhancements resulted in a $1.6 million decrease in the provision for commercial and construction loans, offset by a $1.6 million increase in the provision for consumer loans in the second quarter of 2018.

See "Basis of Presentation" below for a reconciliation of the GAAP provision for loan and lease losses to the non-GAAP provision for loan and lease losses excluding the effect of the hurricane-related qualitative reserves mentioned above. Also see "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.

2017 compared to 2016

On a non-GAAP basis, excluding the effect of the above mentioned charges to the hurricane-related qualitative reserves, the adjusted provision for loan and lease losses of $73.0 million for 2017 decreased by $13.7 million as compared to the provision of $86.7 million for 2016. The $13.7 million decrease in the adjusted provision was driven by:

- A $22.6 million decrease in the adjusted provision for commercial and construction loans, primarily reflecting lower specific reserve requirements for impaired loans, a $2.9 million increase in loan loss recoveries, including a $4.2 million recovery recorded on a previously charged-off commercial and industrial loan in Puerto Rico, and the effect in 2016 of a $1.8 million charge associated with the sale of a $16.3 million pool of non-performing assets.

- A $2.8 million decrease in the adjusted provision for consumer loans and finance leases, primarily related to lower delinquency levels for personal and small loans. The three-month hurricane-related deferred repayment arrangements provided to consumer borrowers current in their payments, or no more than two payments in arrears as of the date of the respective hurricanes, affected the delinquency levels of these portfolios during the fourth quarter of 2017.

Partially offset by:

- An $11.1 million increase in the adjusted provision for residential mortgage loans, primarily related to a higher level of nonaccrual residential mortgage loans, increased specific reserves for residential mortgage TDR loans, and higher loss severity estimates in 2017, including adjustments to liquidation cost assumptions.

Non-Interest Income

The following table presents the composition of non-interest income:

	2018	2017	2016
(In thousands)			
Service charges on deposit accounts	$ 21,679	$ 22,314	$ 22,965
Mortgage banking activities	17,228	13,491	20,435

Insurance income	8,429	8,197	8,473
Broker-dealer income	-	-	789
Other operating income	32,742	28,854	30,111
Non-interest income before net (loss) gain on investments securities, and gain on early extinguishment of debt	80,078	72,856	82,773
Net (loss) gain on sale of investments securities	(34)	371	6,104
Gain from recovery of investments previously written off	-	-	1,547
OTTI on debt securities	(50)	(12,231)	(6,687)
Net (loss) gain on investments securities	(84)	(11,860)	964
Gain on early extinguishment of debt	2,316	1,391	4,217
Total	$ 82,310	$ 62,387	$ 87,954

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

Service charges on deposit accounts include monthly fees, overdraft fees, and other fees on deposit accounts as well as corporate cash management fees.

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

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

Broker-dealer income consists of commissions earned from the activities used to be conducted by the Corporation's broker-dealer subsidiary, FirstBank Puerto Rico Securities. As noted above, the Corporation's Board of Directors approved in 2018 a resolution to dissolve FirstBank Securities and its license as brokered-dealer was terminated effective September 30, 2018.

The other operating income category is composed of miscellaneous fees such as debit, credit card and point of sale ("POS") interchange fees, as well as contractual shared revenues from merchant contracts sold in 2015.

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 OTTI charges on the Corporation's investment portfolio.

The gain on early extinguishment of debt is related to the repurchase and cancellation of $23.8 million and $7.3 million in trust-preferred securities of FBP Statutory Trust I in the first quarter of 2018 and third quarter of 2017, respectively, and $10 million in trust-preferred securities of FBP Statutory Trust II in the first quarter of 2016. The Corporation repurchased and cancelled the repurchased trust-preferred securities, which resulted in a commensurate reduction in the related Floating Rate Junior Subordinated Debentures. The Corporation's purchase price equated to 90%, 81% and 70% of the par value of the trust-preferred securities repurchased in the first quarter of 2018, the third quarter of 2017 and the first quarter of 2016, respectively. The 10% discount for the trust-preferred securities repurchased in the first quarter of 2018 resulted in a gain of $2.3 million, the 19% discount for the trust-preferred securities repurchased in the third quarter of 2017, plus accrued interest, resulted in a gain of $1.4 million and the 30% discount for the trust-preferred securities repurchased in the first quarter of 2016, plus accrued interest, resulted in a gain of $4.2 million. These gains are reflected in the consolidated statements of income as a "Gain on early extinguishment of debt." As of December 31, 2018, the Corporation still has Junior Subordinated Deferrable Debentures outstanding in the aggregate amount of $184.2 million.

2018 compared to 2017

Non-interest income for 2018 amounted to $82.3 million, compared to $62.4 million for 2017. The $19.9 million increase in non-interest income was primarily due to:

- The effect in 2017 of the $12.2 million OTTI charge on three Puerto Rico Government debt securities held by the Corporation as part of its available-for-sale securities portfolio, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. As described above, these bonds were sold in the second quarter of 2017.

- A $3.9 million increase in "Other operating income" in the table above, primarily reflecting: (i) a $3.6 million increase in transaction fee income from ATM, POS, credit and debit card interchange fees, and merchant-related transactions; (ii) a $1.2 million increase in gain from sales of fixed assets, primarily assets of relocated or closed banking branches in Florida and Puerto Rico; (iii) the $0.5 million gain from hurricane-related insurance proceeds recorded in 2018; (iv) a $0.4 million increase in fee income from wire transfer activity; and (v) a $0.3 million increase in certain non-deferrable loans fees such as unused commitment fees. These variances were partially offset by a $2.7 million net loss from sales of nonaccrual commercial and construction loans held for sale in 2018.

- A $3.7 million increase in revenues from mortgage banking activities, driven by a net variance of $2.9 million related to adjustments recorded against the valuation allowance of mortgage servicing rights. During 2018, the valuation allowance of mortgage servicing rights was reduced by $1.3 million compared to temporary impairments on servicing rights of $1.6 million recorded in 2017. In addition, mortgage servicing fees increased by $1.1 million. These variances were partially offset by a $0.1 million decrease in net gain on sales of residential mortgage loans. Total loans sold in the secondary market to U.S. government-sponsored entities amounted to $338.1 million with a related net gain of $9.7 million, including realized gains of $0.9 million on To-Be-Announced MBS ("TBA") hedges entered and settled during 2018, compared to total loans sold in the secondary market of $322.5 million with a related net gain of $9.8 million, net of realized losses on TBA hedges of $0.6 million, for 2017. The total amount of loans sold in the secondary market in 2018 included $9.8 million of seasoned residential mortgage loans sold to Fannie Mae that resulted in a gain of $0.2 million.

• A $0.9 million increase in gains on early extinguishment of debt. During the first quarter of 2018, the Corporation recorded a $2.3 million gain on the repurchase and cancellation of $23.8 million in trust-preferred securities, compared to a $1.4 million gain on the repurchase and cancellation of $7.3 million in trust preferred securities recorded in the third quarter of 2017.

Partially offset by:

• A $0.6 million decrease in service charges on deposits, primarily related to a decrease in overdraft and returned items transactions.

2017 compared to 2016

Non-interest income for 2017 amounted to $62.4 million, compared to $88.0 million for 2016. The $25.6 million decrease in non-interest income was primarily due to:

• A $6.9 million decrease in revenues from mortgage banking activities driven by lower conforming loan origination and sales volume in the secondary market associated with both the drop in business activity in Puerto Rico and the Virgin Islands after the hurricanes and higher market interest rates in 2017. Total loans sold in the secondary market to U.S. government-sponsored entities amounted to $322.5 million with a related gain of $9.8 million, net of TBA hedge losses of $0.6 million, for 2017, compared to $482.6 million with a related gain of $15.2 million, including TBA hedge gains of $0.5 million, for 2016. In addition, temporary impairments on servicing rights increased by $1.3 million in 2017 compared to 2016.

• The effect in 2016 of a $6.1 million gain on sales of $198.7 million of U.S. agency MBS.

• A $5.9 million increase in OTTI charges on bonds of the GDB and the Puerto Rico Public Buildings Authority. During the first quarter of 2017, the Corporation recorded a $12.2 million OTTI charge on the above-mentioned bonds that were subsequently sold in the second quarter of 2017. The OTTI charge recorded in

2017 was the fourth OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of $6.3 million, $12.9 million and $3.0 million were booked in the first quarter of 2016, and the second and fourth quarters of 2015, respectively.

- A $2.9 million decrease in gains associated with repurchases and cancellations of trust-preferred securities. During the third quarter of 2017, the Corporation recorded a $1.4 million gain on the repurchase and cancellation of $7.3 million of trust-preferred securities, compared to a $4.2 million gain on the repurchase and cancellation of $10 million of trust-preferred securities in the first quarter of 2016.

- The effect in 2016 of a $1.5 million gain from the recovery of a residual CMO previously written off that was associated with the liquidation of the related trust in the fourth quarter of 2016.

- The effect in 2016 of brokerage and insurance commissions of $1.8 million, primarily related to the sale of large fixed annuities contracts.

Non-Interest Expenses

The following table presents the components of non-interest expenses:

(In thousands)	2018	2017	2016
Employees' compensation and benefits	$ 159,494	$ 151,845	$ 151,493
Occupancy and equipment	57,942	56,659	55,159
FDIC deposit insurance	8,909	13,725	20,055
Taxes, other than income taxes	14,707	14,550	15,139
Professional fees:			
Collections, appraisals and other credit-related fees	7,505	9,160	9,890
Outsourcing technology services	21,075	21,243	20,264
Other professional fees	14,917	15,526	13,983
Credit and debit card processing expenses	15,546	13,212	13,635
Business promotion	14,808	12,485	11,419
Communications	6,372	6,148	6,759
Net loss on OREO and OREO operations	14,452	10,997	11,533
Other	22,075	22,151	25,751
Total	$ 357,802	$ 347,701	$ 355,080

2018 compared to 2017

Non-interest expenses increased by $10.1 million to $357.8 million for the year ended December 31, 2018, compared to $347.7 million for 2017. The increase was primarily due to the following:

- A $7.6 million increase in employees' compensation and benefit expenses, primarily due to salary merit increases and adjustments related to the Corporation's annual salary review process, higher headcount and recruiting expenses, and the effect in 2017 of expected insurance recoveries of approximately $1.4 million in connection with payroll costs incurred when Hurricanes Irma and Maria precluded employees from working during 2017. In addition, there was a $0.6 million increase related to a higher matching contribution to the employees' retirement plans.

- A $3.5 million increase in losses from OREO operations, reflecting a $2.1 million increase in adverse fair value adjustments to the value of OREO properties and a $1.3 million increase in OREO operating expenses, which included insurance, taxes and maintenance fees, and a $0.1 million increase related to lower income recognized from rental payments associated with income-producing commercial properties.

- A $2.3 million increase in business promotion expenses, primarily reflecting a $1.9 million increase related to advertising, marketing, public relations, promotions and sponsorship activities and a $0.9 million increase in the estimated cost of the credit card rewards program, partially offset by a decrease of $1.0 million in expenses associated with relief efforts and assistance to employees and communities after the passage of Hurricanes Irma and Maria during 2017.

- A $2.3 million increase in credit and debit card processing expenses, mainly related to higher transaction volumes.

- A $1.3 million increase in occupancy and equipment expenses, primarily due to hurricane-related expenses incurred in 2018 associated with repairs and security matters and the effect in 2017 of expected insurance recoveries for rental costs of $0.4 million that the Corporation incurred when Hurricanes Irma and Maria precluded the utilization of certain facilities during 2017.

Partially offset by:

- A $4.8 million decrease in the FDIC insurance premium expense reflecting, among other things, the effect of improved earnings trends, reductions in brokered CDs, and higher liquidity levels tied to the growth in non-interest-bearing deposits.

- A $2.4 million decrease in total professional service fees, primarily reflecting a $1.7 million decrease in attorneys' collection, appraisals and credit-related fees, and a $0.8 million decrease in external audit-related fees.

Non-interest expenses decreased by $7.4 million to $347.7 million for the year ended December 31, 2017, compared to $355.1 million for 2016. The decrease was primarily due to the following:

- A $6.3 million decrease in the FDIC insurance premium expense, mainly related to the effect of reductions in brokered deposits and average assets, a strengthened capital position, and improved liquidity metrics.

- A $2.1 million decrease in the provision for unfunded loan commitments and letters of credit, included as part of "Other" in the table above, reflecting lower unused balances on adversely classified commercial lines of credit.

- A $0.8 million decrease in write-downs, loss on sales and expenses related to non-real estate repossessed assets, included as part of "Other" in the table above.

- A $0.6 million decrease in communications-related matters, primarily reductions in telephone and postage expenses.

- A $0.6 million decrease in taxes, other than income taxes, primarily related to reductions in the sales and use taxes and municipal license taxes in Puerto Rico.

- A $0.5 million decrease in losses from OREO operations, primarily reflecting a $1.8 million decrease in write-downs to the value of OREO properties, partially offset by a $1.2 million decrease in rental income from commercial OREO income-producing properties.

- A $0.5 million decrease in the amortization of intangible assets, included as part of “Other” in the table above.

- A $0.4 million decrease in credit and debit card processing expenses, primarily associated with a lower volume of transactions affected by the drop in business activity after the hurricanes in 2017.

Partially offset by:

- A $1.8 million increase in total professional service fees, primarily reflecting higher consulting fees related to the implementation of new technology systems and higher outsourcing fees related to network services, partially offset by lower appraisals and collection fees related to troubled loan resolution efforts.

- A $1.5 million increase in occupancy and equipment costs, primarily due to higher electricity, property taxes and rental expenses. The increase was partially offset by the approximately $0.4 million of expected insurance recoveries for rental costs that the Corporation incurred when Hurricanes Irma and Maria precluded the utilization of certain facilities during 2017.

- A $1.1 million increase in business promotion expenses, reflecting the effect in 2016 of a $2.7 million adjustment recorded to reduce the credit card rewards program liability due to the expiration of reward points earned by customers up to September 2013 (the conversion date of the credit card portfolio acquired from FIA in May 2012) and costs incurred in 2017 of approximately $1.0 million related to hurricane relief efforts and assistance to employees, partially offset by a $1.3 million decrease associated with lower advertising and marketing-related activities.

- A $0.4 million increase in employees’ compensation and benefits, mainly due to salary merit increases and higher stock-based compensation costs as well as costs of $1.2 million recorded in 2017 associated with a cash transition award paid to certain senior officers under the new executive compensation program that became effective on July 1, 2017. These variances were partially offset by the expected insurance recoveries of approximately $1.4 million in connection with payroll costs incurred when Hurricanes Irma and Maria precluded employees from working during 2017.

Income Taxes

Income tax expense includes Puerto Rico and USVI 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. and USVI income tax purposes and, accordingly, is generally subject to U.S. and USVI income tax only on its income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those jurisdictions. Any such tax paid in the U.S. and USVI is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the 2011 PR Code, the Corporation and its subsidiaries are treated as separate taxable entities and are generally not entitled to file consolidated tax returns and, thus, the Corporation is generally not entitled to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from an NOL, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry-forward period. Pursuant to the 2011 PR Code, the carryforward period for NOLs incurred during taxable years that commenced after December 31, 2004 and ended before January 1, 2013 is 12 years; for NOLs incurred during taxable years commencing after December 31, 2012 the carryover period is 10 years. The 2011 PR Code allows an entity organized as a limited liability company to elect to become a non-taxable "pass-through" entity and utilize losses to offset income from other "pass-through" entities, subject to certain limitations, with the remaining net income passing-through to its partner entities. The 2011 PR Code also provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

On March 1, 2017, the Corporation completed the applicable regulatory filings to change the tax status of its subsidiary, First Federal Finance Corp., from a taxable corporation to a non-taxable "pass-through" entity. This election has allowed the Corporation to realize tax benefits of its deferred tax assets associated with pass-through ordinary net operating losses available at the banking subsidiary, FirstBank, which were subject to a full valuation allowance as of December 31, 2016, against now pass-through ordinary income from this profitable subsidiary.

On March 1, 2017, the Corporation also completed the applicable regulatory filings to change the tax status of its subsidiary, FirstBank Insurance, from a taxable corporation to a non-taxable "pass-through" entity. This election has allowed the Corporation to offset pass-through income earned by FirstBank Insurance with net operating losses available at the Holding Company level.

On December 22, 2017, the United States President signed H.R.1, The Tax Cuts and Jobs Acts, effective January 1, 2018, which includes an overhaul of individual, business and international taxes and has affected our branch operations in the U.S. and the USVI. The bill includes measures reducing corporate taxes from 35% to 21%, repealing of the corporate alternative minimum tax regime, changing business deductions and NOLs, and imposing a 15.5% tax on mandatory repatriation of liquid assets, a 10% tax on base erosion payments, and a minimum 10.5% tax on inclusion of global intangible low-tax income by U.S. shareholders, among other significant changes. The main provisions affecting our operations in the U.S. and the USVI for the year 2018 include: the change in the tax rate to 21%, the limitation on the amount certain financial institutions, including the Bank, may deduct for premiums paid to the FDIC, and changes in permanent differences, such as meals and entertainment deductions. Other significant provisions, such as the base erosion and anti-abuse tax, do not affect the Corporation's U.S. and USVI branch operations since these operations' receipts do not exceed the annual threshold of U.S. effectively connected gross receipts.

On December 10, 2018, the Governor of Puerto Rico signed into law Act 257 to amend some of the provisions of the of 2011PR Code. Act 257 introduces various changes to the current income tax regime in the case of individuals and corporations, and the sales and use taxes that are effective on January 1, 2019, including, among others, (i) a reduction in the Puerto Rico maximum corporate tax rate from 39% to 37.5%; (ii) an increase in the net operating and capital losses usage limitation from 80% to 90%; (iii) amendments to the provisions related to "pass-through" entities that provide that corporations that own 50% or more of a partnership will not be able to claim a current or carryover non partnership NOL deduction against a partnership distributable share, adversely impacting the above described tax action taken in 2017 for FirstBank Insurance; and (iv) other limitations on certain deductions, such as meals and entertainment deductions. The PROMESA oversight board accepted the required certification submitted by the Legislature of Puerto Rico (the "Compliance Certification") acknowledging that Act 257 is not significantly inconsistent with the Commonwealth's Fiscal Plan as it applies to Articles 1 through 131 and 164-165. However, the PROMESA oversight board expressed concerns regarding certain provisions of Act 257, specifically Articles 132 through 163, regarding the video lottery terminals that operate outside casinos in Puerto Rico. It is not yet determined whether Act 257 will be further amended to accommodate any mandate from the PROMESA oversight board.

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

For additional information relating to income taxes, see Note 26 – "Income Taxes," of the Corporation's consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K, including the reconciliation of the statutory to the effective income tax rate for 2018, 2017 and 2016.

2018 compared to 2017

For 2018, the Corporation recorded an income tax benefit of approximately $11.0 million compared to an income tax benefit of $5.0 million for 2017. The income tax benefit for 2018 reflects, among others, the effect of a $63.2 million partial reversal of FirstBank's deferred tax asset valuation allowance recorded during the fourth quarter of 2018 and a $24.7 million deferred tax asset valuation release from the utilization and disallowance of NOLs that were partially or fully reserved; partially offset by a one-time charge to the income tax expense of $9.9 million related to the remeasurement of net deferred tax assets, which is net of the $5.6 million related impact in the valuation allowance, as result of the reduction in corporate tax rates as per Act 257. The income tax benefit for 2017 was mostly attributable to the tax benefit related to hurricane-related charges and to a $13.2 million tax benefit resulting from the above discussed change in tax status of certain subsidiaries from taxable corporations to limited liability companies that have elected to be treated as partnerships for income tax purposes in Puerto Rico.

As a result of the partial reversal of the deferred tax asset valuation allowance and the remeasurement of deferred tax assets in connection with the enactment of Act 257, the Corporation's net deferred tax assets amounted to $319.9 million as of December 31, 2018, net of a valuation allowance of $100.7 million, compared to net deferred tax assets of $294.8 million, net of a valuation allowance of $191.2 million as of December 31, 2017. After completion of the deferred tax asset valuation allowance analysis for the fourth quarter of 2018, management concluded that, as of December 31, 2018, it is more likely than not that FirstBank, the banking subsidiary, will generate sufficient taxable income within the applicable NOL carry-forward periods to realize $220.5 million of its deferred tax assets related to NOLs and, therefore, reversed $63.2 million of the valuation allowance. The decision to partially reverse the valuation allowance was reached after weighting all of the evidence and determining that the positive evidence out-weighted the negative evidence. The positive evidence considered by management in arriving at its decision to reverse part of the deferred tax asset valuation allowance was primarily driven by: FirstBank's three-year cumulative income position; the continued profitability following the hurricane events in 2017; and forecasts of future profitability, under several potential scenarios, that support significant utilization of NOLs prior to their expiration ranging between the years 2021 through 2024. The negative evidence considered by management includes: uncertainties around the state of the Puerto Rico economy, including the effect of hurricane recovery funds together with Puerto Rico government debt renegotiation efforts and the ultimate sustainability of the approved Fiscal Plan; and consideration of the Corporation's still elevated levels of non-performing assets.

Management's estimate of future taxable income is based on internal projections that consider historical performance, multiple internal scenarios and assumptions, as well as external data that management believes is reasonable. If events are identified that affect the Corporation's ability to utilize its deferred tax assets, the analysis will be updated to determine if any adjustments to the valuation allowance are required. If actual results differ significantly from the current estimates of future taxable income, even if caused by adverse macro-economic conditions, the remaining valuation allowance may need to be increased. Such an increase could have a material adverse effect on the Corporation's financial condition and results of operations. Conversely, a higher than projected proportion of taxable income to exempt income could lead to a higher usage of available NOLs and a lower amount of disallowed NOLs from projected levels of tax-exempt income, per the 2011 PR code, which in turn could result in further releases to the deferred tax valuation allowance; any such decreases could have a material positive effect on the Corporation's financial condition and results of operations.

As of December 31, 2018, approximately $104 million of the deferred tax assets of the Corporation are attributable to temporary differences or tax credit carry-forwards that have no expiration date, compared to $125.6 million in 2017. The valuation allowance attributable to FirstBank's deferred tax assets of $68.1 million as of December 31, 2018 is related to the estimated NOL disallowance attributable to projected levels of tax-exempt income, NOLs attributable to the Virgin Islands jurisdiction, and capital losses. The remaining balance of $32.6 million of the deferred tax asset valuation allowance non-attributable to FirstBank is mainly related to NOLs and capital losses at the Holding Company and the Bank's subsidiary First Management of Puerto Rico. The Corporation will continue to provide a valuation allowance against its deferred tax assets in each applicable tax jurisdiction until the need for a valuation allowance is eliminated. The need for a valuation allowance is eliminated when the Corporation determines that it is more likely than not the deferred tax assets will be realized. The ability to recognize the remaining deferred tax assets that continue to be subject to a valuation allowance will be evaluated on a quarterly basis to determine if there are any significant events that would affect the ability to utilize these deferred tax assets.

The Corporation has U.S. and USVI sourced NOL carryforwards. Section 382 of the U.S. Internal Revenue Code (the "Section 382") limits the ability to utilize U.S. and USVI NOLs for income tax purposes in such jurisdictions following an event that is considered to be an ownership change. Generally, an "ownership change" occurs when certain shareholders increase their aggregate ownership by more than 50 percentage points over their lowest ownership percentage over a three-year testing period. Upon the occurrence of a Section 382 ownership change, the use of NOLs attributable to the period prior to the ownership change is subject to limitations and only a portion of the U.S. and USVI NOLs may be used by the Corporation to offset its annual U.S. and USVI taxable income, if any.

During 2017, the Corporation completed a formal ownership change analysis within the meaning of Section 382 covering a comprehensive period, and concluded that an ownership change occurred during such period. The ownership change and resulting Section 382 limitation did not cause a U.S. or USVI income tax liability or material income tax expense related to periods prior to 2017 since the Corporation had sufficient post-ownership change NOLs in those jurisdictions to offset taxable income. The Section 382 limitation resulted in higher U.S. and USVI income tax liabilities than we would have incurred in the absence of such limitation. The Corporation has mitigated to an extent the adverse effects associated with the Section 382 limitation as any such tax paid in the U.S. or USVI can be creditable against Puerto Rico tax liabilities or taken as a deduction against taxable income. However, our ability to reduce our Puerto Rico tax liability through such a credit or deduction depends on our tax profile at each annual taxable period, which is dependent on various factors. For the 2018 and 2017 year, and as a result of the Section 382 limitation, the Corporation incurred an income tax expense of approximately $3.8 million and $2.3 million, respectively, related to its U.S. operations. The limitation did not impact the USVI operations for the years 2018 and 2017.

2017 compared to 2016

For 2017, the Corporation recorded an income tax benefit of approximately $5.0 million compared to an income tax expense of $37.0 million for 2016. The tax benefit for 2017, when compared to the tax expense for 2016, was mostly attributable to the tax benefit related to the hurricane-related charges and to the $13.2 million tax benefit recorded in 2017 as a result of the above discussed change in tax status of certain subsidiaries from taxable corporations to limited liability companies that have elected to be treated as partnerships for income tax purposes in Puerto Rico. The $13.2 million tax benefit was primarily associated with the reversal of the $13.9 million deferred tax asset valuation allowance as a result of the change in tax status of First Federal Finance Corp., partially offset by the elimination of the $0.7 million deferred tax asset previously recorded at FirstBank Insurance. The effective tax rate for the year ended December 31, 2017 was (8)% compared to 28% for the year ended December 31, 2016.

OPERATING SEGMENTS

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 based primarily on the Corporation's lines of business for its operations in Puerto Rico, the Corporation's principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2018, the Corporation had six reportable segments: Commercial and Corporate Banking; Consumer (Retail) Banking; Mortgage Banking; Treasury and Investments; United States operations; and Virgin Islands operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors, such as the Corporation's organizational chart, nature of the products, distribution channels and the economic characteristics of its products, were also considered in the determination of the reportable segments. For additional information regarding First BanCorp.'s reportable segments, please refer to Note 35 - "Segment Information," of the Corporation's consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K.

The accounting policies of the segments are the same as those described in Note 1 - "Nature of Business and Summary of Significant Accounting Policies," of the Corporation's consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K. The Corporation evaluates the performance of the segments based on net interest income, the 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. In 2018, 2017, and 2016, other operating expenses not allocated to a particular segment amounted to $107.5 million, $105.4 million, and $101.1 million, respectively. Expenses pertaining to corporate administrative functions that support the operating segment but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.

The Treasury and Investments segment lends funds to the Consumer (Retail) Banking, Mortgage Banking and Commercial and Corporate Banking segments to finance their lending activities and borrows from those segments. The Consumer (Retail) Banking and the United States Operations segments also lend funds to other segments. The interest rates charged or credited by Treasury and Investment, the Consumer (Retail) Banking and the United States Operations segments are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation's actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment.

Commercial and Corporate Banking

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. FirstBank has developed expertise in a wide variety of industries. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. This segment also includes the Corporation's broker-dealer activities, which are primarily concentrated in investment banking activities, such as advisory services, capital raising efforts on behalf of clients and assistance with financial transaction structuring. A substantial portion of the commercial and corporate banking portfolio is secured by the underlying value of the real estate collateral and the personal guarantees of the borrowers. Since commercial loans involve greater credit risk than a typical residential mortgage loan because they are larger in size and more risk is concentrated in a single borrower, the Corporation has and maintains a credit risk management infrastructure designed to mitigate potential losses associated with commercial lending, including underwriting and loan review functions, sales of loan participations and continuous monitoring of concentrations within portfolios.

The highlights of the Commercial and Corporate Banking segment's financial results for the years ended December 31, 2018, 2017 and 2016 include the following:

- Segment income before taxes for the year ended December 31, 2018 was $46.7 million compared to $30.7 million for 2017 and $35.3 million for 2016 for the reasons discussed below.

- Net interest income for the year ended December 31, 2018 was $78.7 million compared to $92.0 million and $96.7 million for the years ended December 31, 2017 and 2016, respectively. The decreases in net interest income in 2018 and 2017 were mainly related to increases in the cost of funds borrowed from other segments resulting from higher short-term market interest rates and a decline in the average balance of commercial and construction loans in Puerto Rico, partially offset by the upward repricing of variable-rate commercial loans during 2017. The average balance of commercial and construction loans in Puerto Rico declined by $215.6 million in 2018, compared to 2017, and by $193.4 million in 2017, compared to 2016.

- The provision for loan losses for 2018 was $4.8 million compared to $33.3 million and $28.6 million for 2017 and 2016, respectively. The decrease in the provision for loan losses for 2018, compared to 2017, reflects the effect of net loan loss reserve releases of $6.2 million recorded in 2018 in connection with revised estimates associated with the effect of Hurricane Maria on commercial and construction loans in Puerto Rico, compared to a charge of $29.8 million recorded in 2017. This was partially offset by an $11.2 million charge to the provision related to fair value write-downs in excess of previously-established reserves on $44.4 million of nonaccrual commercial and construction loans in Puerto Rico transferred to held for sale in 2018. The increase in the provision for loan losses for 2017, compared to 2016, was mainly related to the $29.8 million charge related to inherent losses associated with the effect of Hurricane Maria on commercial and construction loans in Puerto Rico, partially offset by lower specific reserve requirements for impaired loans and an increase in loan loss recoveries.

- Total non-interest income for the year ended December 31, 2018 amounted to $5.2 million compared to $7.2 million and $7.8 million for the years ended December 31, 2017 and 2016, respectively. The decrease in 2018, compared to 2017, was mainly related to charges of $3.3 million related to fair value adjustments and losses realized on the sale of certain nonaccrual construction and commercial loans held for sale in 2018, partially offset by a $1.6 million increase in fee income form merchant-related transactions allocated to this operating segment. The decrease for 2017, compared to 2016, was mainly related to the effect in 2016 of fee income amounting to $0.8 million from the broker-dealer subsidiary primarily associated with the sale of large fixed annuities contracts.

- Direct non-interest expenses for 2018 were $32.4 million, compared to $35.1 million in 2017, and $40.7 million in 2016. The decrease in 2018, compared to 2017, reflects a $1.5 million decrease related to the portion of the FDIC deposit insurance premium allocated to this operating segment, a $1.2 million decrease in attorneys' collection and legal fees related to resolution efforts relating to problem loans in Puerto Rico. The decrease in 2017, compared to 2016, reflects a $2.0 million decrease related to the portion of the FDIC deposit insurance premium allocated to this segment, a $2.1 million decrease in the provision for unfunded lending commitments, primarily related to lower unused balances on floor plan revolving credit agreements, and a $1.0 million aggregate decrease in losses from OREO operations and troubled loan resolution effort expenses in Puerto Rico.

Consumer (Retail) Banking

The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through FirstBank's branch network in Puerto Rico. Loans to consumers include auto, boat and personal loans, credit cards and lines of credit. Deposit products include interest-bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts and retail CDs. Retail deposits gathered through each branch of FirstBank's retail network serve as one of the funding sources for the lending and investment activities.

Consumer lending has been mainly driven by auto loan originations. The Corporation follows a strategy of seeking to provide outstanding service to selected auto dealers that provide the channel for the bulk of the Corporation's auto loan originations.

Personal loans, credit cards, and, to a lesser extent, marine financing also contribute to interest income generated on consumer lending. Management plans to continue to be active in the consumer loan market, applying the Corporation's strict underwriting standards. Other activities included in this segment are finance leases and insurance activities in Puerto Rico.

The highlights of the Consumer (Retail) Banking segment's financial results for the years ended December 31, 2018, 2017 and 2016 include the following:

- Segment income before taxes for the year ended December 31, 2018 was $129.9 million compared to $57.9 million and $66.2 million for the years ended December 31, 2017 and 2016, respectively, for the reasons discussed below.

- Net interest income for the year ended December 31, 2018 was $217.9 million compared to $175.9 million and $168.7 million for the years ended December 31, 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly due to higher income from funds loaned to other business segments due to both the growth in non-brokered deposits, mainly non-interest bearing deposits, that, among others things, served as funding source for lending activities of other operating segments, and higher medium-term market interest rates. In addition, the average volume of consumer loans in Puerto Rico increased by $77.5 million. The increase in 2017, compared to 2016, was mainly due to higher income from funds loaned to other business segments due to higher medium-term market interest rates in 2017, partially offset by a $41.7 million decrease in the average volume of consumer loans in Puerto Rico.

- The provision for loan and lease losses for 2018 decreased by $30.3 million to $23.5 million compared to 2017 and increased by $19.5 million to $53.8 million when comparing 2017 with 2016. The decrease in the provision for loan losses for 2018, compared to 2017, reflects the effect of net loan loss reserve releases of $7.6 million recorded in 2018 in connection with revised estimates associated with the effect of Hurricane Maria on consumer loans in Puerto Rico, compared to a charge of $23.7 million recorded in 2017. The increase in the provision for loan and lease losses in 2017, compared to 2016, was mainly related to the aforementioned hurricane-related charge of $23.7 million, partially offset by lower delinquency levels in 2017.

- Non-interest income for the year ended December 31, 2018 was $47.7 million compared to $43.9 million and $44.5 million for the years ended December 31, 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly related to a $3.2 million increase in transaction fee income from ATMs and POS, and credit and debit card interchange fees. The decrease in 2017, compared to 2016, was mainly related to a $0.3 million decrease in insurance commission income, and a $1.6 million decrease in service charges on deposits, reflecting a decline in the number of returned items and overdraft transactions adversely affected by business activity disruptions caused by Hurricane Maria in Puerto Rico, partially offset by an increase of $1.4 million in ATM and POS fee income.

- Direct non-interest expenses for the year ended December 31, 2018 were $112.2 million compared to $108.2 million and $112.8 million for the years ended December 31, 2017 and 2016, respectively. The increase for 2018, compared to 2017, was mainly related to a $2.2 million increase in credit and debit card processing expenses related to higher transaction volumes, a $1.1 million increase in advertising, marketing and promotion-related expenses, a $0.9 million increase in credit card rewards program costs, and a $0.7 million increase in professional services fees, partially offset by a $0.9 million decrease in the portion of the FDIC insurance premium expense allocated to this operating segment. The decrease for 2017, compared to 2016, was mainly driven by a $1.8 million reduction in the portion of the FDIC insurance premium expense allocated to this operating segment, a $0.4 million decrease in losses and expenses related to non-real estate repossessed assets, a $0.6 million decrease in credit and debit card processing expenses, primarily associated with a lower volume of transactions affected by the drop in business activity in Puerto Rico after the hurricanes in 2017, a $2.5 million decrease in employees' compensation and benefits, including the aforementioned effect of hurricane-related expected insurance recoveries of $0.4 million allocated to this segment, and a $1.0 million decrease in professional service fees, partially offset by a $0.4 million increase in occupancy and equipment costs, and a $1.8 million increase in credit card rewards program costs.

Mortgage Banking

The Mortgage Banking segment conducts its operations mainly through FirstBank. The operation consists of the origination, sale and servicing of a variety of residential mortgage loan products. Originations are sourced through different channels, such as FirstBank branches and purchases from mortgage bankers, and in association with new project developers. The mortgage banking segment focuses on originating residential real estate loans, some of which conform to the FHA, VA and RD standards. Loans originated that meet the FHA's standards qualify for the FHA's insurance program whereas loans that meet the standards of the VA and the RD are guaranteed by their respective federal agencies.

Mortgage loans that do not qualify under these programs are commonly referred to as conventional loans. Conventional real estate loans can be conforming or non-conforming. Conforming loans are residential real estate loans that meet the standards for sale under the FNMA and FHLMC programs whereas loans that do not meet those standards are referred to as non-conforming residential real estate loans. The Corporation's strategy is to penetrate markets by providing customers with a variety of high quality mortgage products to serve their financial needs through a faster and simpler process and at competitive prices. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. Residential real estate conforming loans are sold to investors like FNMA and FHLMC. The Corporation has commitment authority to issue GNMA mortgage-backed securities.

The highlights of the Mortgage Banking segment's financial results for the years ended December 31, 2018, 2017 and 2016 include the following:

- Segment income before taxes for the year ended December 31, 2018 was $45.2 million compared to $14.7 million for 2017 and $46.0 million for 2016 for the reasons discussed below.

- Net interest income for the year ended December 31, 2018 was $79.4 million compared to $86.0 million and $89.5 million for the years ended December 31, 2017 and 2016, respectively. The decrease in net interest income in 2018, compared to 2017, was mainly due to a decrease of $92.0 million in the average balance of residential mortgage loans in Puerto Rico and increases in the cost of funds borrowed from other segments resulting from higher short-term market interest rates. The decrease in net interest income in 2017, compared to 2016, was mainly due to both a higher level of inflows of residential mortgage loans to non-performing status adversely affected by interruptions in collection efforts resulting from Hurricane Maria and a decrease of $108.6 million in the average balance of residential mortgage loans in Puerto Rico.

- The provision for loan and lease losses for 2018 was $13.1 million compared to $47.7 million and $24.9 million for the years ended December 31, 2017 and 2016, respectively. The decrease in the provision for 2018, compared to 2017, was mainly due to the effect in 2017 of a $12.3 million charge related to inherent losses associated with the effect of Hurricane Maria on residential mortgage loans in Puerto Rico, declines in charge-offs, nonaccrual, and delinquent loan levels, the overall decrease in the size of this portfolio, and the effect in 2017 of adjustments to the loss severity estimates used in the calculation of the general reserve. The increase in the provision for 2017, compared to 2016, was mainly driven by the aforementioned $12.3 million hurricane-related charge, and a higher level of nonaccrual residential mortgage loans, increased specific reserves for residential mortgage TDR loans, and higher loss severity estimates in 2017, including adjustments to liquidation cost assumptions.

- Non-interest income for the year ended December 31, 2018 was $17.1 million compared to $12.8 million and $19.5 million for the years ended December 31, 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly due to a positive net variance of $2.9 million related to adjustments recorded against the valuation allowance of mortgage servicing rights, and a $1.1 million increase in mortgage servicing fees. The decrease in 2017, compared to 2016, was mainly due to lower gains on sales of residential mortgage loans in the secondary market associated with both the drop in business activity in Puerto Rico after the hurricanes and higher market interest rates in 2017.

- Direct non-interest expenses in 2018 were $38.2 million compared to $36.4 million and $38.2 million in 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly related to a $4.3 million increase in losses on OREO operations, partially offset by a $1.7 million decrease in the portion of the FDIC insurance premium allocated to this operating segment, and a $0.6 million decrease in professional service fees. The decrease in 2017, compared to 2016, was mainly related to a $2.1 million decrease in the portion of the FDIC insurance premium allocated to this segment, a $0.4 million decrease in business promotion expenses, and a $1.0 million decrease in losses on OREO operations, partially offset by a $1.7 million increase in professional service fees including expenses related to the implementation of new technology systems.

Treasury and Investments

The Treasury and Investments segment is responsible for the Corporation's treasury and investment management functions. The treasury function, which includes funding and liquidity management, lends funds to the Commercial and Corporate Banking segment, the Mortgage Banking segment, and the Consumer (Retail) Banking segment to finance their respective lending activities and borrows from those segments. Funds not gathered by the different business units are obtained by the Treasury function through wholesale channels, such as brokered deposits, advances from the FHLB, and repurchase agreements with investment securities, among others.

The investment function is intended to implement a leverage strategy for the purposes of liquidity management, interest rate risk management and earnings enhancement.

The interest rates charged or credited by Treasury and Investments are based on market rates.

The highlights of the Treasury and Investments segment's financial results for the years ended December 31, 2018, 2017, and 2016 include the following:

- Segment income before taxes for the year ended December 31, 2018 amounted to $61.2 million compared to $41.8 million for 2017 and $54.6 million for 2016 for the reasons discussed below.

- Net interest income for the year ended December 31, 2018 was $61.6 million compared to net interest income of $55.4 million and $53.2 million for the years ended December 31, 2017 and 2016, respectively. The increase in net interest income in 2018, compared to 2017, was mainly related to the gradual reinvestment of liquidity into higher-yielding U.S. agencies MBS and debt securities and the decrease in the average balance of brokered CDs, partially offset by lower income from funds loaned to other business segments due to the overall decrease in the average volume of commercial and residential mortgage loans in Puerto Rico and a higher proportion of the lending activities of other operating segments funded by the growth in non-interest bearing deposits of the Consumer (Retail) Banking operating segment. The increase in net interest income in 2017, compared to 2016, reflects reductions in interest expense associated with the full-year effect of the repayment of $400 million of repurchase agreements that matured in the third and fourth quarters of 2016 that carried an average cost of 3.35% and a decrease in the average balance of brokered CDs.

- Non-interest income for the year ended December 31, 2018 amounted to $2.5 million, compared to non-interest loss of $10.2 million for the year ended December 31, 2017 and non-interest income of $5.4 million for the year ended December 31, 2016. The non-interest income reported in 2018 consisted primarily of the $2.3 million gain on the repurchase and cancellation of $7.3 million in trust-preferred securities. The loss for 2017 was driven by OTTI charges on Puerto Rico government debt securities of $12.2 million, partially offset by the $1.4 million gain on the repurchase and cancellation of $7.3 million in trust-preferred securities. The non-interest income reported in 2016 consisted mainly of the $6.1 million gain on sales of U.S. agency MBS, the $4.2 million gain on the repurchase and cancellation of $10 million in trust-preferred securities, and the $1.5 million recovery of a residual CMO previously written off, partially offset by OTTI charges on debt securities of $6.7 million recorded in 2016, primarily on Puerto Rico government debt securities.

- Direct non-interest expenses for 2018 were $3.0 million compared to $3.4 million and $4.0 million for 2017 and 2016, respectively. The variances are primarily related to costs incurred in professional service fees that decreased by $0.4 million in 2018, compared to 2017, and decreased by $0.5 million in 2017, compared to 2016.

United States Operations

The United States Operations segment consists of all banking activities conducted by FirstBank on the United States mainland. FirstBank provides a wide range of banking services to individual and corporate customers primarily in southern Florida through 10 banking branches. The United States Operations segment offers an array of both consumer and commercial banking products and services. Consumer banking products include checking, savings and money market accounts, retail CDs, internet banking services, residential mortgages, home equity loans and lines of credit, and automobile loans. Retail deposits, as well as FHLB advances and brokered CDs, allocated to this operation serve as funding sources for its lending activities. Deposits gathered through FirstBank's branches in the United States also serve as one of the funding sources for the Corporation's overall lending and investment activities.

The commercial banking services include checking, savings and money market accounts, retail CDs, internet banking services, cash management services, remote data capture and automated clearing house, or ACH, transactions. Loan products include the traditional commercial and industrial ("C&I") and commercial real estate products, such as lines of credit, term loans and construction loans.

The highlights of the United States operations segment's financial results for the years ended December 31, 2018, 2017, and 2016 include the following:

- Segment income before taxes for the year ended December 31, 2018 was $16.6 million compared to $16.0 million and $16.1 million for the years ended December 31, 2017 and 2016, respectively, for the reasons discussed below.

- Net interest income for the year ended December 31, 2018 was $59.1 million compared to $49.2 million and $41.8 million for the years ended December 31, 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly due to a $175.4 million increase in the average volume of loans in the United States, primarily commercial and construction loans, and the upward repricing of variable-rate commercial loans. The increase in 2017, compared to 2016, was mainly due to a $297.0 million increase in the average volume of loans in the United States, primarily commercial and residential mortgage loans.

- During 2018, a provision for loan losses of $11.9 million was recorded for this operating segment, compared to $3.6 million for 2017 and a negative provision of $1.4 million for 2016. The increase in the provision for loan losses in 2018, compared to 2017, primarily reflects the effect of charges of $9.2 million to the specific reserve of a commercial mortgage loan designated as impaired in 2018 and the overall increase in the size of the loan portfolio. The variance in the provision for loan losses in 2017, compared to 2016, primarily reflects the build-up of general reserves associated with the growth in the commercial and residential mortgage loan portfolio in 2017.

- Total non-interest income for the year ended December 31, 2018 amounted to $3.0 million compared to $2.7 million and $3.6 million for the years ended December 31, 2017 and 2016, respectively. The increase in 2018, compared to 2017, primarily reflects the effect of a $0.2 million gain realized on $9.8 million of seasoned residential mortgage loans sold to FNMA in 2018. The decrease in 2017, compared to 2016, was mainly due to the effect in 2016 of a $0.4 million fee recorded as income associated with a terminated credit agreement in which the Bank was committed to purchase a loan participation, and a $0.4 million decrease in gains on the sale of residential mortgage loans attributable to this segment.

- Direct non-interest expenses in 2018 were $33.6 million compared to $32.2 million and $30.7 million for 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly due to an increase of $1.4 million in employees' compensation and benefits, and a $0.4 million increase in professional service fees, partially offset by a $0.6 million decrease in the allocation of the FDIC insurance premium expense. The increase in 2017, compared to 2016, was mainly due to an increase of $1.5 million in employees' compensation and benefits, a $0.2 million increase in occupancy and equipment costs, and a $0.4 million increase in professional service fees, partially offset by a $0.6 million decrease in the allocation of the FDIC insurance premium expense.

Virgin Islands Operations

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the U.S. and British Virgin Islands, including retail and commercial banking services, with a total of 11 banking branches currently serving the islands in the USVI of St. Thomas, St. Croix and St. John, and the island of Tortola in the BVI. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities.

Loans to consumers include auto, boat, lines of credit, and personal and residential mortgage loans. Deposit products include interest-bearing and non-interest bearing checking and savings accounts, IRAs, and retail CDs. Retail deposits gathered through each branch serve as the funding sources for its own lending activities.

The highlights of the Virgin Islands operations' financial results for the years ended December 31, 2018, 2017 and 2016 include the following:

- Segment loss before taxes for the year ended December 31, 2018 was $1.4 million compared to income of $6.3 million and $13.2 million for the years ended December 31, 2017 and 2016, respectively, for the reasons discussed below.

- Net interest income for the year ended December 31, 2018 was $28.7 million compared to $33.2 million and $34.1 million for the years ended December 31, 2017 and 2016, respectively. The decrease in net interest income in 2018, compared to 2017, was mainly related to a $39.5 million decrease in the average balance of commercial and construction loans and a $23.1 million decrease in the average balance of residential mortgage loans. The decrease in net interest income in 2017, compared to 2016, was mainly driven by a $32.8 million decrease in the average balance of residential mortgage loans that offset the $29.8 million increase in the average volume of commercial loans, and the adverse impact of higher inflows of loans to non-performing status adversely affected by interruptions in business activity resulting from Hurricane Irma in the USVI and the BVI.

- During 2018, a provision of $6.0 million was recorded for this segment, compared to a provision of $5.8 million in 2017 and $0.4 million for 2016. The slight increase in the provision for 2018, compared to 2017, was mainly related to charges of $7.4 million recorded in 2018 associated with developments in problem loan resolution strategies, including a $4.5 million charge related to a fair value write-down in excess of a previously-established reserve on a $30.0 million construction loan transferred to held for sale, partially offset by the effect in 2017 of a $5.6 million charge related to inherent losses associated with the effect of Hurricane Irma in the USVI and the BVI. The increase in the provision for 2017, compared to 2016, was mainly driven by the aforementioned hurricane-related charge of $5.6 million.

- Non-interest income for the year ended December 31, 2018 was $6.8 million, compared to $6.0 million and $7.1 million for the years ended December 31, 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly related to a $0.5 million increase in fee-based income from ATMs, POS, credit and debit cards, and merchant-related activities. The decrease in 2017, compared to 2016, was mainly driven by a $0.3 million decrease in non-deferrable loan fees, and the effect in 2016 of a $0.6 million gain on the sale of a real estate property.

- Direct non-interest expenses for the year ended December 31, 2018 were $31.0 million compared to $27.0 million and $27.6 million for the years ended December 31, 2017 and 2016, respectively. The increase in 2018, compared to 2017, was mainly due to a $2.2 million increase in occupancy and equipment costs, including $1.3 million of hurricane-related expenses incurred in 2018 associated with repairs and security matters, a $0.7 million increase in employees' compensation and benefits, and a $0.7 million increase in professional services fees. The decrease in 2017, compared to 2016, was mainly driven by a $0.7 decrease in employees' compensation and benefits, including the effect of expected insurance recoveries of $0.1 million allocated to this segment in connection with payroll costs incurred when Hurricane Irma precluded employees from working during 2017.

FINANCIAL CONDITION AND OPERATING DATA ANALYSIS

Financial Condition

The following table presents an average balance sheet of the Corporation for the following years:

	December 31, 2018	2017	2016
(In thousands)			
ASSETS			
Interest-earning assets:			
Money market and other short-term investments	$ 623,892	$ 416,578	$ 667,838
U.S. and Puerto Rico government obligations	799,358	687,076	746,890
Mortgage-backed securities	1,347,979	1,278,968	1,357,518
FHLB stock	40,389	40,458	31,449
Other investments	2,881	2,702	1,963
Total investments	2,814,499	2,425,782	2,805,658
Residential mortgage loans	3,179,487	3,260,715	3,302,519
Construction loans	117,993	140,038	143,095
Commercial loans	3,629,329	3,723,356	3,694,988
Finance leases	287,400	242,303	229,632
Consumer loans	1,512,984	1,480,265	1,526,475
Total loans	8,727,193	8,846,677	8,896,709
Total interest-earning assets	11,541,692	11,272,459	11,702,367
Total non-interest-earning assets (1)	664,509	700,818	687,775
Total assets	$ 12,206,201	$ 11,973,277	$ 12,390,142
LIABILITIES AND STOCKHOLDERS' EQUITY			
Interest-bearing liabilities:			
Interest-bearing checking accounts	$ 1,288,240	$ 1,116,273	$ 1,073,821
Savings accounts	2,364,774	2,394,708	2,503,047
Certificates of deposit	2,404,764	2,397,443	2,367,874
Brokered CDs	816,229	1,296,479	1,805,443
Interest-bearing deposits	6,874,007	7,204,903	7,750,185
Other borrowed funds	352,729	514,035	833,283
FHLB advances	705,000	680,975	460,861
Total interest-bearing liabilities	7,931,736	8,399,913	9,044,329
Total non-interest-bearing liabilities	2,379,789	1,731,036	1,580,408
Total liabilities	10,311,525	10,130,949	10,624,737
Stockholders' equity:			
Preferred stock	36,104	36,104	36,104
Common stockholders' equity	1,858,572	1,806,224	1,729,301
Stockholders' equity	1,894,676	1,842,328	1,765,405
Total liabilities and stockholders' equity	$ 12,206,201	$ 11,973,277	$ 12,390,142

(1) Includes, among other things, the allowance for loan and lease losses and the valuation of available-for-sale investment securities.

The Corporation’s total average assets were $12.2 billion for the year ended December 31, 2018 compared to $12.0 billion for 2017, an increase of $232.9 million. The variance primarily reflects an increase of $207.3 million in the average volume of interest-bearing cash balances, mainly consisting of deposits at the Federal Reserve Bank of New York, and a $181.4 million increase in the average balance of investment securities, driven by purchases of U.S. agency MBS and debt securities, partially offset by a decrease of $119.5 million in the average volume of loans, primarily in commercial and residential mortgage loans.

The Corporation’s total average liabilities were $10.3 billion as of December 31, 2018, an increase of $180.6 million compared to December 31, 2017. The increase was mainly related to a $779.1 million increase in the average balance of non-brokered deposits, including an increase of $629.8 million in the average balance of non-interest bearing deposits, and an increase of $24.0 million in the average balance of FHLB advances, partially offset by a decrease of $480.2 million in the average balance of brokered CDs, a decrease of $134.0 million in the average balance of repurchase agreements, and a $27.3 million decrease in the average balance of junior subordinated debentures associated with trust-preferred securities.

Assets

The Corporation’s total assets were $12.2 billion as of December 31, 2018, a decrease of $17.7 million from December 31, 2017. The decrease was mainly due to a $130.2 million decrease in cash and cash equivalents, largely driven by liquidity used to repay maturing brokered CDs and borrowings, and a $16.5 million decrease in the OREO portfolio balance.

These variances were partially offset by a $51.6 million increase in available-for-sale investment securities driven by purchases of U.S. agencies MBS and debt securities, a $25.0 million increase in the net deferred tax asset, and a $17.9 million increase in total loans, as further discussed below. The allowance for loan and lease losses decreased by $35.5 million during 2018 reflecting, among other things, the effect of releases associated with revised estimates of the hurricane-related qualitative reserves.

Loans Receivable, including Loans Held for Sale

The following table presents the composition of the loan portfolio, including loans held for sale, as of year-end for each of the last five years.

	2018	2017	2016	2015	2014

(In thousands)					
Residential mortgage loans (1)	$3,163,208	$3,290,957	$3,296,031	$3,344,719	$3,011,187
Commercial loans:					
Commercial mortgage loans (2)	1,522,662	1,614,972	1,568,808	1,537,806	1,665,787
Construction loans (2)	79,429	111,397	124,951	156,195	123,480
Commercial and Industrial loans (2)	2,148,111	2,083,253	2,180,455	2,246,513	2,317,416
Total commercial loans	3,750,202	3,809,622	3,874,214	3,940,514	4,106,683
Finance leases	333,536	257,462	233,335	229,165	232,126
Consumer loans	1,611,177	1,492,435	1,483,293	1,597,984	1,750,419
Total loans held for investment	8,858,123	8,850,476	8,886,873	9,112,382	9,100,415
Less:					
Allowance for loan and lease losses	(196,362)	(231,843)	(205,603)	(240,710)	(222,395)
Total loans held for investment, net	8,661,761	8,618,633	8,681,270	8,871,672	8,878,020
Loans held for sale (2)	43,186	32,980	50,006	35,869	76,956
Total loans, net	$8,704,947	$8,651,613	$8,731,276	$8,907,541	$8,954,976

(1) On February 27, 2015 FirstBank acquired 10 Puerto Rico branches of Doral Bank and acquired, among other things, $324.8 million in principal balance of loans at acquisition, primarily residential mortgage loans.

(2) During the first and third quarters 2018, the Corporation transferred $74.4 million (net of fair value write-downs of $22.2 million recorded at the time of the transfers) in nonaccrual loans to held for sale. Loans transferred to held for sale consisted of nonaccrual commercial mortgage loans totaling $39.6 million (net of fair value write-downs of $13.8 million), nonaccrual construction loans totaling $33.0 million (net of fair value write-downs of $6.7 million) and nonaccrual commercial and industrial loans totaling $1.8 million (net of fair value write-downs of $1.7 million). Approximately $27.2 million of the commercial mortgage loans transferred to loan held for sale and $30.0 million of the construction loans transferred to loans held for sale were eventually sold during the second, third and fourth quarters of 2018.

Lending Activities

As of December 31, 2018, the Corporation's total loan portfolio, before allowance, amounted to $8.9 billion, an increase of $17.9 million when compared to December 31, 2017. The increase consisted of a $168.6 million growth in the Florida region, partially offset by reductions of $103.4 million and $47.4 million in the Virgin Islands and Puerto Rico regions, respectively. Total loans for 2018 reflect an increase in the consumer loan portfolio of $194.8 million, partially offset by reductions of $125.4 million and $51.6 million in the residential mortgage and commercial and construction loan portfolios, respectively.

The increase in total loans in the Florida region consisted of a $164.8 million growth in commercial and construction loans, a $2.2 million increase in consumer loans, and a $1.7 million increase in residential mortgage loans. In recent years, the Corporation has invested in facilities, increased its resources dedicated to commercial and corporate banking functions and invested in a technology platform in Florida as the Corporation expects to achieve continued growth in this region.

The decrease in total loans in the Puerto Rico region consisted of a $143.1 million decrease in commercial and construction loans and a $96.5 million decrease in residential mortgage loans, partially offset by a $192.2 million growth in consumer loans. The decrease in commercial and construction loans was mainly related to eight large commercial loans paid off during 2018 totaling $88.7 million, the sale of four large adversely-classified commercial and construction loans totaling $39.1 million, and charge-offs and repayments recorded during 2018. These declines were partially offset by certain large originations closed in 2018, including three new commercial loans, each in individual amount in excess of $15 million and totaling $64.0 million, and purchases and refinancings that increased the balance of two participated commercial loans by approximately $44.8 million.

The decrease in total loans in the Virgin Islands region consisted of a $73.3 million decrease in commercial and construction loans and a $30.5 million decrease in residential mortgage loans, partially offset by a $0.4 million increase in consumer loans. The decrease in commercial and construction loans was driven by the sale of a nonaccrual construction loan of $27.0 million (net of charge-offs of $5.1 million and payments of $3.0 million recorded on such loan during 2018), a $14.6 million decrease in the outstanding principal balance of loans granted to government entities, and a $6.7 million commercial mortgage loan paid off in 2018.

As shown in the table above, as of December 31, 2018, the loans held-for-investment portfolio was comprised of commercial and construction loans (42%), residential real estate loans (36%), and consumer and finance leases (22%). Of the total gross loan portfolio held for investment of $8.9 billion as of December 31, 2018, approximately 74% had credit risk concentration in Puerto Rico, 21% in the United States (mainly in the state of Florida) and 5% in the Virgin Islands, as shown in the following table:

As of December 31, 2018	**Puerto Rico**	**Virgin Islands**	**United States**	**Total**
(In thousands)				
Residential mortgage loans	$ 2,313,230	$ 252,363	$ 597,615	$ 3,163,208
Commercial mortgage loans	1,014,023	74,585	434,054	1,522,662
Construction loans	26,069	11,303	42,057	79,429
Commercial and Industrial loans	1,351,661	95,900	700,550	2,148,111
Total commercial loans	2,391,753	181,788	1,176,661	3,750,202
Finance leases	333,536	-	-	333,536
Consumer loans	1,505,720	46,838	58,619	1,611,177
Total loans held for investment, gross	$ 6,544,239	$ 480,989	$ 1,832,895	$ 8,858,123
Loans held for sale	41,794	199	1,193	43,186
Total loans, gross	$ 6,586,033	$ 481,188	$ 1,834,088	$ 8,901,309

As of December 31, 2017	**Puerto Rico**	**Virgin Islands**	**United States**	**Total**
(In thousands)				
Residential mortgage loans	$ 2,413,379	$ 282,738	$ 594,840	$ 3,290,957
Commercial mortgage loans	1,127,409	95,464	392,099	1,614,972
Construction loans	41,511	43,314	26,572	111,397
Commercial and Industrial loans	1,373,714	116,323	593,216	2,083,253
Total commercial loans	2,542,634	255,101	1,011,887	3,809,622
Finance leases	257,462	-	-	257,462
Consumer loans	1,389,560	46,412	56,463	1,492,435
Total loans held for investment, gross	$ 6,603,035	$ 584,251	$ 1,663,190	$ 8,850,476
Loans held for sale	30,397	325	2,258	32,980
Total loans, gross	$ 6,633,432	$ 584,576	$ 1,665,448	$ 8,883,456

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

The following table sets forth certain additional data (including loan production) related to the Corporation's loan portfolio net of the allowance for loan and lease losses as of the dates indicated:

	For the Year Ended December 31,				
	2018	2017	2016	2015	2014
(Dollars in thousands)					
Beginning balance as of January 1	$ 8,651,613	$ 8,731,276	$ 8,907,541	$ 8,954,976	$ 9,259,643
Residential real estate loans originated and purchased (1)	531,971	549,147	749,653	703,749	826,937
Construction loans originated and purchased	65,243	58,103	19,019	32,604	39,041
C&I and commercial mortgage loans originated and purchased	1,737,366	1,729,659	1,601,618	1,734,233	1,842,697
Finance leases originated	164,334	93,670	87,246	84,978	76,765
Consumer loans originated and purchased	991,950	785,516	780,148	835,719	916,251
Total loans originated and purchased	3,490,864	3,216,095	3,237,684	3,391,283	3,701,691
Loans acquired from Doral Bank	-	-	-	311,410	-
Sales of loans	(420,549)	(375,754)	(514,489)	(598,840)	(394,736)
Repayments and prepayments	(2,959,438)	(2,788,758)	(2,801,024)	(2,970,373)	(3,483,590)
Other decreases (2)	(57,543)	(131,246)	(98,436)	(180,915)	(128,032)
Net increase (decrease)	53,334	(79,663)	(176,265)	(47,435)	(304,667)
Ending balance as of December 31	$ 8,704,947	$ 8,651,613	$ 8,731,276	$ 8,907,541	$ 8,954,976
Percentage invrease (decrease)	0.62%	(0.91)%	(1.98)%	(0.53)%	(3.29)%

(1) For 2014, includes the purchase from Doral Bank of $192.6 million in outstanding principal balance of performing residential mortgage loans.
(2) Includes, among other things, the change in the allowance for loan and lease losses and cancellation of loans due to
the repossession of the collateral and loans repurchased.

Residential Real Estate Loans

As of December 31, 2018, the Corporation's residential mortgage loan portfolio held for investment decreased by $127.7 million, as compared to the balance as of December 31, 2017, mainly resulting from activities in Puerto Rico and the Virgin Islands as principal repayments, charge-offs, and foreclosures exceeded the volume of new loans originated and held for investment purposes. The residential mortgage loan portfolio held for investment in the Puerto

Rico and Virgin Islands regions decreased during year 2018 by $100.1 million and $30.4 million, respectively, partially offset by an increase of $2.8 million in the Florida region. Approximately 77% of the $420.7 million in residential mortgage loans originated in Puerto Rico during 2018 consisted of conforming loan originations sold in the secondary market and refinancings. The increase in the Florida region was achieved despite the sale of $9.8 million of seasoned residential mortgage loans to FNMA in the second quarter of 2018.

The majority of the Corporation’s outstanding balance of residential mortgage loans in Puerto Rico and the Virgin Islands consisted of fixed-rate loans that traditionally carried higher yields than residential mortgage loans in Florida. In the Florida region, approximately 56% of the residential mortgage loan portfolio consisted of adjustable-rate mortgages. In accordance with the Corporation’s underwriting guidelines, residential mortgage loans are mostly fully documented loans, and the Corporation does not originate negative amortization loans.

Residential mortgage loan originations and purchases for the year ended December 31, 2018 amounted to $532.0 million compared to $549.1 million for 2017 and $749.7 million for 2016. These statistics include purchases from mortgage bankers of $46.1 million for the year ended December 31, 2018, compared to $58.9 million in 2017 and $85.0 million in 2016. The lower volume of residential mortgage loan originations in 2018, compared to 2017, consisted of a $62.8 million decline in the Florida region, partially offset by an increase of $45.5 million in Puerto Rico. Loan originations in 2017 were adversely affected by disruptions in economic activity associated with Hurricanes Irma and Maria, primarily in the Puerto Rico region.

Commercial and Construction Loans

As of December 31, 2018, the Corporation's commercial and construction loan portfolio, including loans held for sale, decreased by $51.6 million to $3.8 billion, as compared to the balance as of December 31, 2017. The decrease consisted of declines of $143.1 million and $73.3 million in Puerto Rico and the Virgin Islands, respectively, partially offset by a $164.8 million growth in the Florida region. As explained above, the decline in the Puerto Rico and the Virgin Island regions include the effect of adversely-classified and nonaccrual loans sold during 2018 totaling $66.1 million (net of charge-offs of $11.0 million and payments of $7.4 million recorded on such loans during 2018), and the repayment in 2018 of certain large commercial loans individually in excess of $5 million and totaling $95.4 million.

As of December 31, 2018, the Corporation had $61.6 million outstanding in loans extended to the Puerto Rico government, its municipalities and public corporations, compared to $55.9 million as of December 31, 2017. Approximately $47.2 million of the outstanding loans as of December 31, 2018 consisted of loans extended to municipalities in Puerto Rico, which in most cases are supported by assigned property tax revenues. The vast majority of revenues of the municipalities included in the Corporation's loan portfolio are independent of the Puerto Rico central government. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. Late in 2015, the GDB and the Municipal Revenue Collection Center ("CRIM") signed and perfected a deed of trust. Through this deed, the GDB, as fiduciary, is bound to keep the CRIM funds separate from any other deposits and must distribute the funds pursuant to applicable law. The CRIM funds are deposited at another commercial depository financial institution in Puerto Rico. In addition to loans extended to municipalities, the Corporation's exposure to the Puerto Rico government as of December 31, 2018 included a $14.5 million loan granted to an affiliate of the Puerto Rico Electric Power Authority ("PREPA").

The Corporation also has credit exposure to USVI government entities. As of December 31, 2018, the Corporation had $55.8 million in loans to USVI government instrumentalities and public corporations, compared to $70.4 million as of December 31, 2017. Of the amount outstanding as of December 31, 2018, public corporations of the USVI owed approximately $32.6 million and an independent instrumentality of the USVI government owed approximately $23.2 million. As of December 31, 2018, all loans were currently performing and up to date on principal and interest payments.

Furthermore, during 2018, the Corporation reached resolution on the three commercial mortgage loans granted to the hotel industry in Puerto Rico that were formerly guaranteed by the Puerto Rico Tourism Development Fund ("TDF"). Historically, the borrower and the operations of the underlying collateral of these loans were the primary sources of repayment and the TDF, which is a subsidiary of the GDB, provided a secondary guarantee for payment performance. The Corporation sold two of these three loan that carried a book value of $27.2 million (net of cumulative charge-offs of $22.0 million), realizing an additional loss of $2.7 million at the time of sale in 2018. In addition, the largest of these three facilities was paid-off during the fourth quarter of 2018. This facility carried a book value of $28.8 million (net of cumulative charge-offs of $28.4 million). A loan loss recovery of $7.4 million was recorded at the time of the repayment in 2018. The sales and repayments of such loans resulted in a $70.8 million reduction in nonaccrual loans during 2018.

As of December 31, 2018, the Corporation's total exposure to shared national credit ("SNC") loans amounted to $844.7 million. As of December 31, 2018, approximately $277.6 million of the SNC exposure related to the portfolio in Puerto Rico and $567.1 million related to the portfolio in the Florida region.

Commercial and construction loan originations (excluding government loans) amounted to $1.8 billion for each of 2018 and 2017, and $1.6 billion in 2016. A decrease of $19.4 million, when compared to 2017, reflect a decrease of $27.5 million in Florida, partially offset by increases of $6.3 million and $1.4 million in the Puerto Rico and Virgin Islands regions, respectively.

Government loan originations for 2018 amounted to $34.6 million, mainly related to the origination in the third quarter of 2018 of a $15.0 million loan extended to a municipality in Puerto Rico and the utilization of an overdraft line of credit of a government entity in the Virgin Islands region. There were no government loans originated in 2017, compared to government loan originations of $54.8 million in 2016.

The composition of the Corporation's construction loan portfolio held for investment as of December 31, 2018 by category and geographic location follows:

As of December 31, 2018

(In thousands)	Puerto Rico	Virgin Islands	United States	Total
Loans for residential housing projects:				
Mid-rise (1)	$ 545	$ 956	$ -	$ 1,501
Single-family, detached	-	1,157	7,123	8,280
Total for residential housing projects	545	2,113	7,123	9,781
Construction loans to individuals secured by residential properties	326	1,051	-	1,377
Loans for commercial projects	10,200	6,146	31,626	47,972
Land loans - residential	8,963	1,996	3,308	14,267
Land loans - commercial (2)	6,095	-	-	6,095
Total before net deferred fees and allowance for loan losses	$ 26,129	$ 11,306	$ 42,057	$ 79,492
Net deferred fees	(60)	(3)	-	(63)
Total construction loan portfolio, gross	26,069	11,303	42,057	79,429
Allowance for loan losses	(2,644)	(943)	(5)	(3,592)
Total construction loan portfolio, net (2)	$ 23,425	$ 10,360	$ 42,052	$ 75,837

(1) Mid-rise relates to buildings of up to seven stories.
(2) Excludes a land-commercial loan held for sale of $3.0 million in Puerto Rico.

The following table presents further information on the Corporation's construction portfolio as of and for the year ended December 31, 2018:

(Dollars in thousands)	
Total undisbursed funds under existing commitments	$ 160,905
Construction loans held for investment in non-accrual status	$ 8,362
Construction loans held for sale in non-accrual status	$ 3,015
Net charge offs - Construction loans	$ 7,962
Allowance for loan losses - Construction loans	$ 3,592
Nonaccrual construction loans to total construction loans, including held for sale	13.80%
Allowance for loan losses - construction loans to total construction loans held for investment	4.52%
Net charge-offs (annualized) to total average construction loans	6.75%

Consumer Loans and Finance Leases

As of December 31, 2018, the Corporation's consumer loan and finance lease portfolio increased by $194.8 million to $1.9 billion, as compared to the portfolio balance as of December 31, 2017. The increase primarily reflects increases in auto loans, finance leases, and personal loans, which increased by $102.1 million, $76.1 million, and $36.4 million, respectively, partially offset by reductions in credit card, boat loans and home equity lines of credit of $13.2 million, $3.0 million and $2.5 million, respectively. The increase was primarily associated with a higher level of consumer loan originations in the Puerto Rico region during 2018.

Originations of auto loans (including finance leases) in 2018 amounted to $588.3 million, an increase of $199.5 million, compared to $388.8 million in 2017. The increase was primarily reflected in the Puerto Rico and Virgin Islands regions with increases of $196.8 million and $4.1 million, respectively, partially offset by a $1.5 million reduction in Florida. Personal loan originations in 2018, other than credit cards, amounted to $225.6 million compared to $183.7 million in 2017. Most of the increase in personal loan originations was reflected in the Puerto Rico region. The utilization activity on the outstanding credit card portfolio in 2018 amounted to $342.4 million compared to $306.6 million in 2017.

Investment Activities

As part of its liquidity, revenue diversification and interest rate risk strategies, First BanCorp. maintains an investment portfolio that is classified as available for sale or held to maturity. The Corporation's total available-for-sale investment securities portfolio as of December 31, 2018 amounted to $1.9 billion, a $51.6 million increase from December 31, 2017. The increase was mainly driven by purchases of U.S. agencies' debt and mortgage-backed securities totaling $459.8 million (average yield of 3.09%), partially offset by prepayments of $215.5 million related to U.S. agencies' pass-through mortgage-backed securities and SBA guaranteed certificates, the maturity during 2018 of $122.5 million of U.S. agencies debt securities, sales of $47.8 million of U.S. agency MBS and debt securities, and a $19.8 million decrease in the fair value of available-for-sale investment securities.

As of December 31, 2018, approximately 99% of the Corporation's available-for-sale securities portfolio was invested in U.S. Government and agency debentures and fixed-rate U.S. government-sponsored agencies MBS (mainly GNMA, FNMA and FHLMC fixed-rate securities). In addition, as of December 31, 2018, the Corporation owned bonds of the Puerto Rico Housing Finance Authority classified as available for sale in the aggregate amount of $8.2 million, carried on the Corporation's books at their aggregate fair value of $7.0 million, which were current as to contractual payments as of December 31, 2018. Approximately $4.2 million (fair value - $2.8 million) of these bonds consist of residential pass-through mortgage-backed securities issued by the Puerto Rico Housing Finance Authority that are collateralized by certain second mortgages originated under a program launched by the Puerto Rico government in 2010. These bonds were structured as zero-coupon bonds for the first ten years (up to July 2019).

As of December 31, 2018, the Corporation's held-to-maturity investment securities portfolio amounted to $144.8 million, down $5.8 million from December 31, 2017. Held-to-maturity investment securities consisted of financing arrangements with Puerto Rico municipalities issued in bond form, which are accounted for as securities, but were underwritten as loans with features that are typically found in commercial loans. These obligations typically are not issued in bearer form, are not registered with the SEC, and are not rated by external credit agencies. These bonds have seniority to the payment of operating costs and expenses of the municipality and are supported by assigned property tax revenues. Approximately 70% of the Corporation's municipality bonds consisted of obligations issued by three of the largest municipalities in Puerto Rico. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans.

See "Risk Management – Exposure to Puerto Rico Government" below for information and details about the Corporation's total direct exposure to the Puerto Rico government.

The following table presents the carrying value of investments as of December 31, 2018 and 2017:

(In thousands)	2018	2017
Money market investments	$ 7,590	$ 10,415
Investment securities available for sale, at fair value:		
U.S. government and agencies obligations	608,656	609,188
Puerto Rico government obligations	6,952	6,813
Mortgage-backed securities	1,326,460	1,274,497
Other	500	518
Total investment securities available for sale, at fair value	1,942,568	1,891,016
Investment securities held to maturity, at amortized cost:		
Puerto Rico Municipal Bonds	144,815	150,627
Equity securities, including $41.9 million and $40.9 million of FHLB stock as of December 31, 2018 and 2017, respectively	44,530	43,119
Total money market investments and investment securities	$ 2,139,503	$ 2,095,177

Mortgage-backed securities as of December 31, 2018 and 2017 consisted of:

(In thousands)	2018	2017
Available-for-sale:		
FHLMC certificates	$ 349,778	$ 311,706
GNMA certificates	182,777	221,630
FNMA certificates	714,044	680,040
Collateralized mortgage obligations issued or guaranteed by FHLMC or GNMA	65,947	44,061
Other mortgage pass-through certificates	13,914	17,060
Total mortgage-backed securities	$ 1,326,460	$ 1,274,497

The carrying values of investment securities classified as available for sale and held to maturity as of December 31, 2018 by contractual maturity (excluding mortgage-backed securities) are shown below:

(In thousands)		Carrying Amount	Weighted-average yield %
U.S. government and agencies obligations			
Due within one year	$	197,079	1.28
Due after one year through five years		182,805	2.07
Due after five years through ten years		194,362	2.95
Due after ten years		34,410	2.68
		608,656	2.13
Puerto Rico government and municipalities obligations			
Due after one year through five years		6,100	4.79
Due after five years through ten years		57,144	5.94
Due after ten years		88,523	5.91
		151,767	5.88
Other Investment Securities			
Due after one year through five years		500	2.96
Total		760,923	2.88
Mortgage-backed securities		1,326,460	2.71
Total investment securities available for sale and held to maturity	$	2,087,383	2.77

Net interest income of future periods could be affected by prepayments of mortgage-backed securities. Any acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration of the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by the Corporation's investment in callable securities. As of December 31, 2018, the Corporation had approximately $286.2 million in debt securities (U.S. Agencies and Puerto Rico government securities) with embedded calls, primarily purchased at a discount, and with an average yield of 2.74%. See "Risk Management" below for further analysis of the effects of changing interest rates on the Corporation's net interest income and the interest rate risk management strategies followed by the Corporation. Also refer to Note 5 – Investment Securities, of the consolidated financial statements included in Item 8 of this Form 10-K, for additional information regarding the Corporation's investment portfolio.

Investment Securities and Loans Receivable Maturities

The following table presents the maturities or repricings of the loan and investment portfolio as of December 31, 2018:

		2-5 Years		Over 5 Years		
(In thousands)	**One Year or Less**	**Fixed - Interest Rates**	**Variable - Interest Rates**	**Fixed - Interest Rates**	**Variable - Interest Rates**	**Total**
Investments:						
Money market investments	$ 7,590	$ -	$ -	$ -	$ -	$ 7,590
Mortgage-backed securities	79,982	19,905	-	1,226,573	-	1,326,460
Other securities (1)	404,672	186,010	-	214,771	-	805,453
Total investments	492,244	205,915	-	1,441,344	-	2,139,503
Loans: (2) (3)						
Residential mortgage	492,494	322,743	212,849	2,151,642	10,555	3,190,283
C&I and commercial mortgage	2,693,217	436,848	242,288	311,516	-	3,683,869
Construction	74,699	7,375	-	370	-	82,444
Finance leases	94,528	234,218	-	4,790	-	333,536
Consumer	618,917	879,502	-	112,758	-	1,611,177
Total loans	3,973,855	1,880,686	455,137	2,581,076	10,555	8,901,309
Total earning assets	$ 4,466,099	$ 2,086,601	$ 455,137	$ 4,022,420	$ 10,555	$ 11,040,812

(1) Equity securities and loans having no stated scheduled repayment date and no stated maturity were included under the "one year or less category."
(2) Scheduled repayments were reported in the maturity category in which the payment is due and variable rates were reported based on the next repricing date.
(3) Nonaccrual loans were included under the "one year or less category."

RISK MANAGEMENT

General

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 eleven broad categories of risks: (1) liquidity risk; (2) interest rate risk; (3) market risk; (4) credit risk; (5) operational risk; (6) legal and compliance risk; (7) reputational risk; (8) model risk; (9) capital risk; (10) strategic risk; and (11) information technology risk. First BanCorp. has adopted policies and procedures designed to identify and manage the risks to which the Corporation is exposed.

Risk Definition

Liquidity Risk

Liquidity risk is the risk to earnings or capital arising from the possibility that the Corporation will not have sufficient cash to meet its short-term liquidity demands, such as from deposit redemptions or loan commitments. See *Liquidity and Capital Adequacy* below for further details.

Interest Rate Risk

Interest rate risk is the risk arising from adverse movements in interest rates. See *Interest Rate Risk Management* below for further details.

Market Risk

Market risk is the risk arising from adverse movements in market rates or prices, such as interest rates or equity prices. The Corporation evaluates market risk together with interest rate risk. Both changes in market values and changes in interest rates are evaluated and forecasted. See *Interest Rate Risk Management* below for further details.

Credit Risk

Credit risk is the risk arising from a borrower's or a counterparty's failure to meet the terms of a contract with the Corporation or otherwise to perform as agreed. See *Credit Risk Management* below for further details.

Operational Risk

Operational risk is the risk arising from problems with the delivery of services or products. This risk is a function of internal controls, information systems, employee integrity and operating processes. It also includes risks associated with the Corporation's preparedness for the occurrence of an unforeseen event. This risk is inherent across all functions, products and services of the Corporation. See *Operational Risk* below for further details.

Legal and Regulatory Risk

Legal and regulatory risk is the risk arising from the Corporation's failure to comply with laws or regulations that can adversely affect the Corporation's reputation and/or increase its exposure to litigation or penalties.

Reputational Risk

Reputational risk is the risk arising from any adverse effect on the Corporation's market value, capital or earnings arising from negative public opinion, whether true or not. This risk affects the Corporation's ability to establish new relationships or services, or to continue servicing existing relationships.

Model Risk

Model risk is the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports. The use of models exposes the Corporation to some level of model risk. Model errors can contribute to incorrect valuations and lead to operational errors, inappropriate business decisions or incorrect financial entries. Model risk can be reduced substantially through rigorous model identification and validation.

Capital Risk

Capital risk is the risk that the Corporation may lose value on its capital or have an inadequate capital plan, which would result in insufficient capital resources to meet minimum regulatory requirements (the Corporation's authority to operate as a bank is dependent upon the maintenance of adequate capital resources), support its credit rating, or support its growth and strategic options.

Strategic Risk

Strategic risk refers to the risk arising from adverse business decisions, poor implementation of business decisions, or lack of responsiveness to changes in the banking industry and operating environment. This risk is a function of the compatibility of the Corporation's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation.

Information Technology Risk

Information Technology risk is the risk arising from the loss of confidentiality, integrity, or availability of information or information systems and of cyber incidents or data breaches. It includes business risks associated with the use, ownership, operation, involvement, influence, and adoption of information technology within the Corporation.

Risk Governance

The following discussion highlights the roles and responsibilities of the key participants in the Corporation's risk management framework:

Board of Directors

The Board of Directors oversees the Corporation's overall risk governance program with the assistance of the Board Committees discussed below.

Risk Committee

The Risk Committee is appointed by the Board of Directors of the Corporation to assist the Board in fulfilling its responsibility to oversee the Corporation's management of its company-wide risk management framework. The Committee's role is one of oversight, recognizing that management is responsible for designing, implementing and maintaining an effective risk management framework. The Committee's primary responsibilities are to:

- Review and discuss management's assessment of the Corporation's aggregate enterprise-wide profile and the alignment of the Corporation's risk profile with the Corporation's strategic plan, goals and objectives;

- Review and recommend to the Board the articulation and establishment of the Corporation's risk tolerance and risk appetite;

- Receive reports from management and, if appropriate, other Board committees, regarding the Corporation's policies and procedures related to the Corporation's adherence to risk limits and its established risk tolerance and risk appetite or on selected risk topics;

- Oversee the strategies, policies, procedures, and systems established by management to identify, assess, measure, and manage the major risks facing the Corporation, which may include an overview of the Corporation's credit risk, operational risk, compliance risk, interest rate risk, liquidity risk, market risk, and reputational risk, as well as management's capital management, planning and assessment process;

- Oversee management’s activities with respect to capital planning, including stress testing and model risk;

- Review and discuss with management risk assessments for new products and services; and

Oversee the Corporation’s legal and regulatory compliance.

Asset/Liability Committee

The Asset/Liability Committee is appointed by the Board of Directors to assist the Board in its oversight of the Corporation’s asset and liability management policies related to the management of the Corporation’s funds, investments, liquidity, and interest rate risk, and the use of derivatives. In doing so, the Committee’s primary functions involve:

- The establishment of a process to enable the identification, assessment, and management of risks that could affect the Corporation’s assets and liabilities management;

- The identification of the Corporation’s risk tolerance levels for yield maximization relating to its assets and liabilities management; and

- The evaluation of the adequacy, effectiveness and compliance with the Corporation’s risk management process relating to the Corporation’s assets and liabilities management, including management’s role in that process.

Credit Committee

The Credit Committee is appointed by the Board of Directors to assist the Board in its oversight of the Corporation's policies related to the Corporation's lending function, hereafter "Credit Management." The Committee's primarily responsibilities are to:

- Review the quality of the Corporation's credit portfolio and the trends affecting that portfolio;
- Oversee the effectiveness and administration of credit-related policies;
- Approve loans as required by the lending authorities approved by the Board; and
- Report to the Board regarding Credit Management.

Audit Committee

The Audit Committee is appointed by the Board of Directors to assist the Board of Directors in fulfilling its responsibility to oversee management regarding:

- The conduct and integrity of the Corporation's financial reporting to any governmental or regulatory body, stockholders, other users of the Corporation's financial reports and the public;
- The performance of the Corporation's internal audit function;
- The Corporation's internal control over financial reporting and disclosure controls and procedures;

- The qualifications, engagement, compensation, independence and performance of the Corporation's independent auditors, their conduct of the annual audit of the Corporation's financial statements, and their engagement to provide any other services;

- The application of the Corporation's related person transaction policy as established by the Board of Directors;

- The application of the Corporation's code of business conduct and ethics as established by management and the Board of Directors; and

- The preparation of the Audit Committee report required to be included in the Corporation's annual stockholders' meeting proxy statement by the rules of the SEC.

Compliance Committee

The Compliance Committee assists the Board of the Bank in fulfilling its responsibility with respect to any actions required by the FDIC and the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico to improve the financial condition of the Bank.

Corporate Governance and Nominating Committee

The Corporate Governance and Nominating Committee is appointed by the Board of Directors to develop, review and assess corporate governance principles. The Corporate Governance and Nominating Committee is responsible for director succession, orientation and compensation, identifying and recommending new director candidates, overseeing the evaluation of the Board and management, recommending to the Board the designation of a candidate to hold the position of the Chairman of the Board, and directing and overseeing the Corporation's executive succession plan.

Compensation and Benefits Committee

The Compensation and Benefits Committee of the Corporation is appointed by the Board of Directors to oversee compensation policies and practices including the evaluation and recommendation to the Board of the proper and competitive salaries and incentive compensation programs of the executive officers and key employees of the Corporation. The Committee recommends guidelines and principles for compensation programs of executive officers and key employees of the Corporation, including establishing a clear link between pay and performance and safeguards against the encouragement of excessive risk-taking.

Management Roles and Responsibilities

While the Board of Directors is charged with the oversight of the risk governance program, the responsibility for implementing the necessary policies and procedures, and internal controls is delegated to the management of the Corporation. To carry out these responsibilities, the Corporation has a clearly defined risk governance culture. To ensure that risk management is communicated at all levels of the Corporation, and each area understands its specific role, there are several management level committees that have been established to support risk oversight, as follows:

Executive Risk Management Committee

The Executive Risk Management Committee is responsible for exercising oversight of information regarding First BanCorp.'s enterprise risk management framework, including the significant policies, procedures, and practices employed to manage the identified risk categories (credit risk, operational risk, legal and regulatory risk, reputational risk, model risk, and capital risk). In carrying out its oversight responsibilities, each Committee member is entitled to rely on the integrity and expertise of those people providing information to the Committee and on the accuracy and completeness of such information, absent actual knowledge of the inaccuracy.

The Committee is appointed by the Chief Executive Officer and provides Senior and Executive management with the opportunity to share their insights about the types of risks that could impede the Corporation's ability to achieve its business objectives. The Chief Risk Officer of the Corporation directs the agenda for the meetings and the Enterprise Risk Management and Operational Risk Director serves as Secretary of the Committee and maintains the minutes on behalf of the Committee. The General Auditor also participates on the Committee as an observer.

The Committee provides assistance and support to the Chief Risk Officer to promote effective risk management throughout the Corporation. The Chief Risk Officer and the ERM and Operational Risk Director report to the Committee matters related to the enterprise risk management framework of the Corporation, including, but not limited to:

- The risk governance structure;
- The risk competencies of the Corporation;
- The Corporation's risk appetite statement and risk tolerance; and
- The risk management strategy and associated risk management initiatives and how both support the business strategy and business model of the Corporation.

Regional Risk Management Committee

This management committee is appointed by the Chief Risk Officer of the Corporation to assist the Corporation in overseeing, and receiving information regarding the Corporation's policies, procedures and practices relating to the Corporation's identified risks in the regions of Florida and the USVI and BVI. In so doing, the Regional Committee's primary general functions involve:

- The evaluation of different risks within the regions to identify any gaps and the implementation of any necessary controls to close such gaps;

- The establishment of a process to enable the recognition, assessment, and management of the risks that could affect the regions; and

• The responsibility to ensure that the Executive Risk Management Committee receives appropriate information about the Corporation's identified risks within the regions.

Other Management Committees

As part of its governance framework, the Corporation has various additional risk management related-committees. These committees are jointly responsible for ensuring adequate risk measurement and management in their respective areas of authority. At the management level, these committees include:

• Management's Investment and Asset Liability Committee ("MIALCO") – oversees interest rate and market risk, liquidity management and other related matters. Refer to *Liquidity Risk and Capital Adequacy and Interest Rate Risk Management* below for further details.

• Information Technology Steering Committee – oversees and counsels on matters related to information technology and cyber security, including the development of information management policies and procedures throughout the Corporation.

• Bank Secrecy Act Committee – oversees, monitors and reports on the Corporation's compliance with the Bank Secrecy Act.

• Credit Committees (consisting of a Credit Management Committee and a Delinquency Committee) – oversees and establishes standards for credit risk management processes within the Corporation. The Credit Management Committee is responsible for the approval of loans above an established size threshold. The Delinquency Committee is responsible for the periodic review of (a) past-due loans, (b) overdrafts, (c) non-accrual loans, (d) OREO assets, and (e) the Bank's watch list and nonaccrual loans.

• Vendor Management Committee – oversees policies, procedures and related practices related to the Corporation's vendor management efforts. The Vendor Management Committee's primary functions involve the establishment of processes and procedures to enable the recognition, assessment, management and monitoring of vendor management risks.

• The Community Reinvestment Act Executive Committee – oversees, monitors and reports on the Corporation's compliance with CRA regulatory requirements. The Bank is committed to develop programs and products that increase access to credit and create a positive impact on low and moderate income individuals and communities.

- Anti-Fraud Committee – oversees the Corporation's policies, procedures and related practices relating to the Corporation's anti-fraud measures.

- Regulatory Compliance Committee - oversees the Corporation's Regulatory Compliance Management System. The Regulatory Compliance Committee reviews and discusses any regulatory compliance laws and regulations that impact performance of regulatory compliance policies, programs and procedures. Ensures the coordination of regulatory compliance requirements throughout departments and business units.

- Regulatory Reporting Committee – oversees and assists the Senior Officers in fulfilling their responsibility for oversight of the accuracy and timeliness of the required regulatory reports and related policies and procedures, addresses changes and/or concerns communicated by the regulators and addresses issues identified during the regulatory reporting process. The Regulatory Reporting Committee oversees the established controls and procedures designed to ensure that information in regulatory reports is recorded, processed, and reported accurately and on a timely basis.

- Complaints Management Committee – assists in overseeing the complaint management process implemented across the Corporation within the three marketplaces; Puerto Rico, Eastern Caribbean Region (USVI and BVI) and Florida. The Complaints Management Committee supports the Corporation's Complaints Management Program relating to resolution of complaints within the lines of business. When appropriate, the Complaints Management Committee evaluates existing corrective actions within lines of business related to complaints and complaint management practices within the units.

- Project Portfolio Management Committee – reviews and oversees the performance of the portfolio and individual projects during the Project Management Cycle (Initiation, Planning, Execution, Control & Monitoring, and Closing). The Project Portfolio Management Committee balances conflicting demands between projects, decides on priorities assigned to each project based on organizational priorities and capacity, oversees project budgets, risks and actions taken to control and mitigate risks.

- Current Expected Credit Losses (“CECL”) Committee – oversees the Corporation’s implementation of the requirements for calculation of CECL, including the implementation of new models, selection of vendors and monitor new guidance from different regulatory agencies with regards to the implementation of CECL. The CECL Committee reports to the Credit and Audit Committee progress of the implementation plan.

Officers

As part of its governance framework, the following officers play a key role in the Corporation’s risk management process:

- Chief Executive Officer (“CEO”) - responsible for the overall risk governance structure of the Corporation. The CEO is ultimately responsible for business strategies, strategic objectives, risk management priorities, and policies.

- Chief Risk Officer (“CRO”) - responsible for the oversight of the risk management of the Corporation as well as the risk governance processes. The CRO, together with the Enterprise Risk Management and Operational Risk Director, monitor key risks and manage the operational risk program. The CRO provides the leadership and strategy for the Corporation’s risk management and monitoring activities and is responsible for the oversight of regulatory compliance, loan review, model risk, and operational risk management.

- Chief Credit Risk Officer, Chief Lending Officer and other senior executives - responsible for managing and executing the Corporation’s credit risk program.

- Chief Financial Officer (“CFO”), together with the Corporation’s Treasurer - manage the Corporation’s interest rate and market and liquidity risk programs and, together with the Corporation’s Chief Accounting Officer, are responsible for the implementation of accounting policies and practices in accordance with GAAP and applicable regulatory requirements. The CFO is assisted by the Risk Assessment Manager in the review of the Corporation’s internal control over financial reporting and disclosure controls and procedures.

- Chief Accounting Officer - responsible for the development and implementation of the Corporation's accounting policies and practices and the review and monitoring of critical accounts and transactions to ensure that they are managed in accordance with GAAP and applicable regulatory requirements.

- Strategic Planning Director - responsible for the development of the Corporation's strategic and business plan, by coordinating and collaborating with the executive team and all corporate bodies concerned with the strategic and business planning process.

- Investors Relations and Capital Planning Officer - responsible for improving the effective communication with investors, while enhancing the Corporation's Capital Plan based on the stress test processes and proactively managing capital. The Investor Relations and Capital Planning Officer will work with the Treasury, ALM, Financial Analysis, Corporate Credit Risk, and Strategic Planning units in order to follow a holistic approach to proactively manage risk and returns for shareholders under the stress testing framework.

- ERM and Operational Risk Director - responsible for driving the identification, assessment, measurement, mitigation and monitoring of key risks throughout the Corporation. The ERM and Operational Risk Director promotes and instills a culture of risk control, identifies and monitors the resolution of major and critical operational risk issues across the Corporation, and serves as a key advisor to business executives with regards to risk exposure to the organization, corrective actions and corporate policies and best practices to mitigate risks.

- Compliance Director - responsible for oversight of regulatory compliance. The Compliance Director maintains an inventory of applicable regulations, implements an enterprise-wide compliance risk assessment, and monitors compliance with significant regulations. The Compliance Director is responsible for building awareness of, and educating business units and subsidiaries on, regulatory risks.

- General Counsel - responsible for the oversight of legal risks, including matters such as contract structuring, litigation risk and all legal-related aspects. The Corporate Affairs Officer assists the General Counsel with various legal areas, including, but not limited, to SEC reporting matters, insurance coverage and liability, and contract structuring.

- Corporate Security Officer ("CSO") - responsible for the oversight of information security policies and procedures, and the ongoing monitoring of existing and new vendors' due diligence for information security. In addition, the CSO identifies risk factors, and determines solutions to security needs.

Other Officers

In addition to a centralized Enterprise Risk Management function, certain lines of business and corporate functions have their own risk managers and support staff. The risk managers, while reporting directly within their respective line of business or function, facilitate communications with the Corporation's risk functions and work in partnership with the CRO and CFO to ensure alignment with sound risk management practices and expedite the implementation of the enterprise risk management framework and policies.

Liquidity Risk and Capital Adequacy, Interest Rate Risk, Credit Risk, Operational Risk, Legal and Compliance Risk and Concentration Risk Management

The following discussion highlights First BanCorp.'s adopted policies and procedures for liquidity risk and capital adequacy, interest rate risk, credit risk, operational risk, legal and compliance risk and concentration risk.

Liquidity Risk and Capital Adequacy

Liquidity is the ongoing ability to accommodate liability maturities and deposit withdrawals, fund asset growth and business operations, and meet contractual obligations through unconstrained access to funding at reasonable market rates. Liquidity management involves forecasting funding requirements and maintaining sufficient capacity to meet liquidity 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 non-banking subsidiaries. The second is the liquidity of the banking subsidiary. As of December 31, 2018, FirstBank could not pay any dividend to the holding company, except upon receipt of required regulatory approvals. During 2018, the Corporation reinstated quarterly dividend payments on its common stock, and continued to pay quarterly interest payments on the subordinated debentures associated with its trust preferred securities and the monthly dividend income on its non-cumulative perpetual monthly income preferred stock pursuant to regulatory approvals.

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 MIALCO, using measures of liquidity developed by management that involve the use of several assumptions, reviews the Corporation's liquidity position on a monthly basis. The MIALCO oversees liquidity management, interest rate risk and other related matters.

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

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

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

The Corporation manages its liquidity in a proactive manner and maintains a sound liquidity position. It uses multiple measures to monitor the liquidity position, including core liquidity, basic liquidity, and time-based reserve measures. As of December 31, 2018, the estimated core liquidity reserve (which includes cash and free liquid assets) was $1.9 billion, or 15.6% of total assets, relatively unchanged as compared to December 31, 2017. The basic liquidity ratio (which adds available secured lines of credit to the core liquidity) as of December 31, 2018 was approximately 19.0% of total assets, compared to 21.2% of total assets as of December 31, 2017. As of December 31, 2018, the Corporation had $422.2 million available for additional credit from the FHLB of New York. Unpledged liquid securities as of December 31, 2018, mainly fixed-rate MBS and U.S. agencies' debentures, amounted to approximately $1.2 billion. The Corporation does not rely on uncommitted inter-bank lines of credit (federal funds lines) to fund its operations and does not include them in the basic liquidity measure. As of December 31, 2018, the holding company had $17.1 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of December 31, 2018 were approximately $579.3 million. The Bank had $555.6 million in brokered CDs as of December 31, 2018, of which approximately $259.6 million mature over the next twelve months. Liquidity at the Bank level is highly-dependent on bank deposits, which fund 74% of the Bank's assets (or 69%, excluding brokered CDs).

Sources of Funding

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

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

The Corporation has continued reducing the amounts of its outstanding brokered CDs. As of December 31, 2018, the amount of brokered CDs had decreased $594.9 million to $555.6 million from $1.2 billion as of December 31, 2017. At the same time as the Corporation focuses on reducing its reliance on brokered CDs, it is seeking to add core deposits. In 2018, the Corporation increased non-brokered deposits, excluding government deposits, by $318.2 million to $7.5 billion, as further discussed below.

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

The Corporation's principal sources of funding are:

Deposits

The following table presents the composition of total deposits:

	Weighted Average Cost as of December 31, 2018		**As of December 31,**	
		2018	**2017**	**2016**
(Dollars in thousands)				
Interest-bearing savings accounts	0.64%	$ 2,334,949	$ 2,401,385	$ 2,518,496
Interest-bearing checking accounts	0.39%	1,304,043	1,207,511	1,075,929
Certificates of deposit	1.61%	2,960,241	3,580,070	3,752,625
Interest-bearing deposits	1.03%	6,599,233	7,188,966	7,347,050
Non-interest-bearing deposits		2,395,481	1,833,665	1,484,155
Total		$ 8,994,714	$ 9,022,631	$ 8,831,205
Interest-bearing deposits:				
Average balance outstanding		$ 6,874,007	$ 7,204,903	$ 7,750,185
Non-interest-bearing deposits:				
Average balance outstanding		$ 2,209,958	$ 1,580,177	$ 1,415,913
Weighted average rate during the period on interest-bearing deposits		0.98%	0.92%	0.87%

Brokered CDs – Historically, a large portion of the Corporation's funding has been brokered CDs issued by FirstBank. Total brokered CDs decreased during 2018 by $594.9 million to $555.6 million as of December 31, 2018.

The average remaining term to maturity of the retail brokered CDs outstanding as of December 31, 2018 was approximately 1.3 years.

The use of brokered CDs has historically 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 CD market is very competitive and liquid, and has enabled the Corporation to obtain substantial amounts of funding in short periods of time. This strategy has enhanced the Corporation's liquidity position, since brokered CDs are insured by the FDIC up to regulatory limits and can be obtained faster than regular retail deposits.

The following table presents contractual maturities of time deposits with denominations of $100,000 or higher as of December 31, 2018:

		Total (In thousands)
Three months or less	$	386,411
Over three months to six months		288,579
Over six months to one year		547,880
Over one year		994,665
Total	$	2,217,535

Certificates of deposit in denominations of $100,000 or higher include brokered CDs of $555.6 million issued to deposit brokers in the form of large certificates of deposit that are generally participated out by brokers in shares of less than the FDIC insurance limit.

Government deposits – As of December 31, 2018, the Corporation had $677.3 million of Puerto Rico public sector deposits ($544.6 million in transactional accounts and $132.7 million in time deposits), compared to $490.3 million as of December 31, 2017. Approximately 34% is from municipalities and municipal agencies in Puerto Rico and 66% is from public corporations and the central government and agencies.

In addition, as of December 31, 2018, the Corporation had $223.4 million of government deposits in the Virgin Islands, compared to $161.7 million as of December 31, 2017.

Retail deposits – The Corporation's deposit products also include regular saving accounts, demand deposit accounts, money market accounts and retail CDs. Total deposits, excluding brokered CDs and government deposits, increased by $318.2 million to $7.5 billion from a balance of $7.2 billion as of December 31, 2017. The higher balance reflects increases of $304.7 million and $88.4 million in Puerto Rico and the Virgin Islands, respectively, partially offset by a $75.0 million decrease in Florida. After the hurricanes and during 2018, the Corporation experienced rapid accumulation of deposits. Total deposits as of December 31, 2018, excluding brokered CDs and government deposits, increased $318.2 million from December 31, 2017 and $695.2 million since September 30, 2017. The most significant increase was in non-interest-bearing demand deposits, which grew 31%, or $561.8 million, between December 31, 2017 and December 31, 2018, and 51%, or $809.3 million, between September 30, 2017 and December 31, 2018. Hurricane-related factors, such as the effect of disaster relief funds and settlement of insurance claims, contributed to this growth. Although management expects the balances accumulated by deposit customers in the hurricane-affected areas to reduce over time, it is difficult to predict when and to what degree, and there may be further growth as insurance claims are resolved and additional disaster-recovery funds are distributed. See Note 16 – "Deposits and Related Interest," in the consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K for further details.

See “Results of Operations - Net Interest Income” above for information about average balances of interest-bearing deposits, and the average interest rate paid on deposits for the years ended December 31, 2018, 2017 and 2016.

Borrowings

As of December 31, 2018, total borrowings amounted to $1.07 billion as compared to $1.22 billion and $1.19 billion as of December 31, 2017 and 2016, respectively.

The following table presents the composition of total borrowings as of the dates indicated:

	Weighted Average Rate as of December 31, 2018	**As of December 31, 2018**	**2017**	**2016**
(Dollars in thousands)				
Securities sold under agreements to repurchase	2.46%	$ 150,086	$ 300,000	$ 300,000
Advances from FHLB	2.07%	740,000	715,000	670,000
Other borrowings	5.38%	184,150	208,635	216,187
Total (1)		$ 1,074,236	$ 1,223,635	$ 1,186,187
Weighted average rate during the period		3.02%	2.54%	2.62%

(1) Includes borrowings of $439.2 million as of December 31, 2018 that have variable interest rates or have maturities within a year.

Securities sold under agreements to repurchase - The Corporation's investment portfolio is funded in part with repurchase agreements. The Corporation's outstanding securities sold under repurchase agreements amounted to $350.1 million as of December 31, 2018, compared to $500 million as of December 31, 2017. The Corporation repaid in the first quarter of 2018 a $100 million short-term repurchase agreement carried at a cost of 1.53%. In addition, during the third quarter of 2018, the Corporation repaid a $100 million long-term repurchase agreement called before its contractual maturity, which had an interest rate of 1.96%. One of the Corporation's strategies has been the use of structured repurchase agreements and long-term repurchase agreements to reduce liquidity risk and manage exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding costs at reasonable levels. In addition to these repurchase agreements, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. See Note 17, "Securities Sold Under Agreements to Repurchase," in the consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K for further details about repurchase agreements outstanding by counterparty and maturities.

As of December 31, 2018, the Corporation had $200 million of reverse repurchase agreements with a counterparty under a master netting arrangement that provides for a right of setoff that meets the conditions of Accounting Standards Codification ("ASC") Topic 210-20-45-11 for a net presentation. These repurchase agreements and reverse repurchase agreements are presented net on the consolidated statement of financial condition.

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

Given the quality of the collateral pledged, the Corporation has not experienced margin calls from counterparties arising from credit-quality-related write-downs in valuations.

Advances from the FHLB – The Bank is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain qualifying mortgages and/or investments as collateral for advances taken. As of December 31, 2018, the outstanding balance of FHLB advances was $740.0 million, compared to $715.0 million as of December 31, 2017. During 2018, the Corporation repaid at maturity $95.0 million of fixed-rate advances from the FHLB carried at an average cost of 1.63%, offset by new 3-Year advances entered into in 2018 totaling $120.0 million with an average cost of 2.65%. As of December 31, 2018, the Corporation had $422.2 million available for additional credit on FHLB lines of credit.

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

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

The trust-preferred debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings. The variable-rate trust-preferred securities are fully and unconditionally guaranteed by the Corporation. The $100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the $125 million issued in September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of the subordinated debentures may be shortened (such shortening would result in a mandatory redemption of the variable-rate trust-preferred securities). The Collins Amendment of the Dodd-Frank Act eliminated certain trust-preferred securities from Tier 1 Capital. Bank holding companies, such as the Corporation, were required to fully phase out these instruments from Tier I capital by January 1, 2016; however, they may remain in Tier 2 capital until the instruments are redeemed or mature.

As mentioned above, during the first quarter of 2018, the Corporation completed the repurchase of $23.8 million of trust-preferred securities of the FBP Statutory Trust I that were being auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust-preferred securities, which resulted in a commensurate reduction in the related subordinated debenture. As of December 31, 2018, the Corporation still had subordinated debentures outstanding in the aggregate amount of $184.2 million.

During the second quarter of 2016, the Corporation received approval from the Federal Reserve and paid $31.2 million for all the accrued but deferred interest payments, plus the interest for the 2016 second quarter, on the Corporation's subordinated debentures associated with its trust-preferred securities. Subsequently, the Corporation has received quarterly regulatory approvals and made scheduled quarterly interest payments. As of December 31, 2018, the Corporation was current on all interest payments due related to its subordinated debentures. On October 3, 2017, the New York FED terminated the Written Agreement entered into on June 3, 2010 between the Corporation and the Federal Reserve. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust-preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock. The Corporation has received approval to make the subordinated debentures' quarterly payment through December 2019, subject to conditions established in the agreement with regulators.

Other Sources of Funds and Liquidity - The Corporation's principal uses of funds are for the origination of loans and the repayment of maturing deposits and borrowings. In connection with its mortgage banking activities, the Corporation has invested in technology and personnel to enhance the Corporation's secondary mortgage market capabilities.

The enhanced capabilities improve the Corporation's liquidity profile as they allow the Corporation to derive liquidity, if needed, from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid, in large part because of the sale of mortgages through guarantee programs of the FHA, VA, U.S. Department of Housing and Urban Development ("HUD"), FNMA and FHLMC. During 2018, the Corporation sold approximately $233.2 million of FHA/VA mortgage loans to GNMA, which packages them into mortgage-backed securities. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

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

Effect of Credit Ratings on Access to Liquidity

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

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

As of December 31, 2018, the Corporation's credit as a long-term issuer was rated B+ by S&P and B by Fitch. At the FirstBank subsidiary level, long-term issuer ratings as of December 31, 2018 were Caa1 by Moody's, seven notches below their definition of investment grade, B+ by S&P, four notches below their definition of investment grade, and B by Fitch, six notches below their definition of investment grade. The Corporation's credit ratings are dependent on a number of factors, both quantitative and qualitative, and are subject to change at any time. The disclosure of credit ratings is not a recommendation to buy, sell or hold the Corporation's securities. Each rating should be evaluated independently of any other rating.

Cash Flows

Cash and cash equivalents were $586.2 million as of December 31, 2018, a decrease of $130.2 million when compared to the balance as of December 31, 2017. The following discussion highlights the major activities and transactions that affected the Corporation's cash flows during 2018 and 2017:

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 foreseeable future.

For 2018 and 2017, net cash provided by operating activities was $288.3 million and $236.0 million, respectively. Net cash generated from operating activities was higher than reported net income largely as a result of adjustments for items such as the provision for loan and lease losses, depreciation and amortization, and impairments, as well as the cash generated from sales of loans held for sale.

Cash Flows from Investing Activities

The Corporation's investing activities primarily relate to originating loans to be held for investment and the purchasing, selling and repaying of available-for-sale and held-to-maturity investment securities. For the year ended December 31, 2018, net cash used in investing activities was $223.3 million, primarily reflecting the effect of purchases of U.S. agencies' debt and mortgage-backed securities, partially offset by U.S. agencies MBS prepayments and proceeds from the aforementioned sales of adversely-classified commercial loans and seasoned residential mortgage loans.

For the year ended December 31, 2017, net cash used in investing activities was $73.3 million, primarily reflecting the effect of purchases of investment securities completed during 2017.

Cash Flows from Financing Activities

The Corporation's financing activities primarily include the receipt of deposits and the issuance of brokered CDs, the issuance and payments on long-term debt, the issuance of equity instruments and activities related to its short-term funding. During the year ended December 31, 2018, net cash used by financing activities was $195.3 million, mainly reflecting the effect of the repayment of maturing brokered CDs and borrowings, dividends paid on common and preferred stock, and the cash used for the repurchase and cancellation of trust-preferred securities, partially offset by the increase in non-brokered deposits.

For the year ended December 31, 2017, net cash provided by financing activities was $254.0 million, mainly due to the increase in non-brokered deposits and higher reliance on FHLB advances, partially offset by the repayment of maturing brokered CDs, dividends paid on preferred stock, and the cash used for the repurchase and cancellation of trust-preferred securities.

Capital

As of December 31, 2018, the Corporation's stockholders' equity was $2.0 billion, an increase of $175.6 million from December 31, 2017. The increase was mainly driven by the earnings generated in 2018, partially offset by the decrease in the fair value of available-for-sale investment securities recorded as part of other comprehensive loss in total equity and dividends paid on preferred and common stock. During the fourth quarter of 2018, for the first time since June 2009, the Corporation declared a quarterly cash dividend of $0.03 per common share, or an aggregate $6.5 million. On December 31, 2016, for the first time since July 2009, the Corporation paid dividends on its non-cumulative perpetual monthly income preferred stock, after receiving regulatory approval. Since then, the Corporation has continued to pay monthly dividend payments on the non-cumulative perpetual monthly income preferred stock. As mentioned above, on October 3, 2017, the Federal Reserve terminated the Written Agreement entered into on June

3, 2010 between the Corporation and the Federal Reserve. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust-preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock. The Corporation received regulatory approvals to pay the monthly dividends on the Corporation's Series A through E Preferred Stock and quarterly dividends on the common stocks through December 2019, subject to conditions established in the agreement with regulators. The Corporation intends to request approval in future periods to continue to pay monthly dividend payments on the non-cumulative perpetual monthly income preferred stock and quarterly dividends on common stock.

Set forth below are First BanCorp.'s and FirstBank's regulatory capital ratios as of December 31, 2018 and December 31, 2017:

			Banking Subsidiary		
	First BanCorp.		FirstBank		To be well capitalized - General thresholds
As of December 31, 2018	**Actual**	**Fully Phased-in (1)**	**Actual**	**Fully Phased-in (1)**	
Total capital ratio (Total capital to risk-weighted assets)	24.00%	23.50%	23.51%	23.02%	10.00%
Common Equity Tier 1 capital ratio (Common equity Tier 1 capital to risk-weighted assets)	20.30%	19.86%	18.76%	18.35%	6.50%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	20.71%	20.26%	22.25%	21.76%	8.00%
Leverage ratio	15.37%	15.37%	16.53%	16.53%	5.00%

			Banking Subsidiary		
	First BanCorp.		FirstBank		To be well capitalized - General thresholds
As of December 31, 2017	**Actual**	**Fully Phased-in (1)**	**Actual**	**Fully Phased-in (1)**	
Total capital ratio (Total capital to risk-weighted assets)	22.53%	21.99%	22.06%	21.53%	10.00%
Common Equity Tier 1 capital ratio (Common equity Tier 1 capital to risk-weighted assets)	18.96%	18.09%	17.70%	16.86%	6.50%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	18.97%	18.49%	20.79%	20.26%	8.00%
Leverage ratio	14.03%	14.01%	15.39%	15.37%	5.00%

(1) Certain adjustments required under Basel III rules were phased-in through the end of 2018 although certain elements of the Basel III rules have recently been deferred by the federal banking agencies. The ratios shown in this column were calculated assuming fully phased-in adjustments as if they were

effective as of December 31, 2018 and 2017.

Although the Corporation and FirstBank became subject to the Basel III rules beginning on January 1, 2015, certain requirements of the Basel III rules are being phased-in over several years and, in general, will be fully effective as of January 1, 2019. Certain elements of the new rules have been deferred by the federal banking agencies. The Corporation and FirstBank compute risk-weighted assets using the Standardized Approach required by the Basel III rules.

The Basel III rules require the Corporation to maintain an additional capital conservation buffer of 2.5% to avoid limitations on both (i) capital distributions (*e.g.*, repurchases of capital instruments, dividends and interest payments on capital instruments) and (ii) discretionary bonus payments to executive officers and heads of major business lines. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional Common Equity Tier 1 capital ("CET1"), which is being progressively increased, by that same percentage amount on each subsequent January 1 until it reached the fully phased-in 2.5% CET1 requirement on January 1, 2019.

Under the fully phased-in Basel III rules, in order to be considered adequately capitalized, the Corporation will be required to maintain: (i) a minimum CET1 capital to risk-weighted assets ratio of at least 4.5%, plus the 2.5% "capital conservation buffer," resulting in a required minimum CET1 ratio of at least 7%; (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5%; (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5%; and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets.

In addition, as required under the Basel III rules, the Corporation's trust-preferred securities ("TRUPs") were fully phased out from Tier 1 capital as of January 1, 2016. However, the Corporation's TRUPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

On November 21, 2017, the Federal Reserve Board, FDIC, and Office of the Comptroller of the Currency finalized an extension of the phase-in of certain Basel III capital rules for banks not using the Basel advanced approaches capital rule. The extension, which was effective on January 1, 2018, pauses the full transition to the Basel III treatment of mortgage servicing assets, certain deferred tax assets, and investments in the capital of unconsolidated financial institutions and minority interests, pending the banking agencies' broader efforts, announced in September 2017, to simplify the regulatory capital rules that apply to banking organizations that are not subject to the advanced approaches capital rules. Because the advanced approaches rules apply to banking organizations with more than $250 billion in assets or foreign bank subsidiaries with more than $10 billion in assets, the extension relief applies broadly to community, midsize, and regional banks, including the Corporation and FirstBank.

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

The following table is a reconciliation of the Corporation's tangible common equity and tangible assets for the years ended December 31, 2018 and 2017, respectively:

(In thousands, except ratios and per share information)	December 31, 2018		December 31, 2017	
Total equity - GAAP	$	2,044,704	$	1,869,097
Preferred equity		(36,104)		(36,104)
Goodwill		(28,098)		(28,098)
Purchased credit card relationship intangible		(5,702)		(8,000)
Core deposit intangible		(4,335)		(5,478)
Insurance customer relationship intangible		(622)		(775)
Tangible common equity	**$**	**1,969,843**	**$**	**1,790,642**
Total assets - GAAP	$	12,243,561	$	12,261,268
Goodwill		(28,098)		(28,098)
Purchased credit card relationship intangible		(5,702)		(8,000)
Core deposit intangible		(4,335)		(5,478)
Insurance customer relationship intangible		(622)		(775)
Tangible assets	**$**	**12,204,804**	**$**	**12,218,917**
Common shares outstanding		**217,235**		**216,278**
Tangible common equity ratio		**16.14%**		**14.65%**
Tangible book value per common share	$	**9.07**	$	**8.28**

On May 17, 2018, the U.S. Department of the Treasury fully exercised its warrant to purchase 1,285,899 shares of the Corporation's common stock on a cashless basis, resulting in the issuance of 730,571 shares of common stock.

The Banking Law of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to a legal surplus reserve until such surplus equals the total of paid-in capital on common and preferred stock. Amounts transferred to the legal surplus reserve from the retained earnings account are not available for distribution to the Corporation, including for payment as dividends to the stockholders, without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The Puerto Rico Banking Law provides that, when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts must be charged against the undistributed profits of the bank, and the balance, if any, must be charged against the legal surplus reserve, as a reduction thereof. If there is no legal surplus reserve sufficient to cover such balance in whole or in part, the outstanding amount must be charged against the capital account and the Bank cannot pay dividends until it can replenish the legal surplus reserve to an amount of at least 20% of the original capital contributed. During 2018 and 2017, $20.5 million and $7.3 million, respectively, were transferred to the legal surplus reserve. FirstBank's legal surplus reserve, included as part of retained earnings in the Corporation's statement of financial condition, amounted to $80.2 million and $59.7 million as of December 31, 2018 and 2017, 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 from the full contract or notional amount of the transaction. These transactions are designed to (1) meet the financial needs of customers; (2) manage the Corporation's credit, market or liquidity risks; (3) diversify the Corporation's funding sources; and (4) optimize capital.

As a provider of financial services, the Corporation routinely enters into commitments with off-balance sheet risk to meet the financial needs of its customers. These financial instruments may include loan commitments and standby letters of credit. These commitments are subject to the same credit policies and approval process used for on-balance sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. As of December 31, 2018, commitments to extend credit amounted to approximately $1.4 billion, of which $680.9 million related to credit card loans. Commercial and financial standby letters of credit amounted to approximately $72.5 million.

Contractual Obligations and Commitments

The following table presents information about the maturities of the Corporation's contractual obligations and commitments, which consist of CDs, long-term contractual debt obligations, and commitments to extend credit:

	Contractual Obligations and Commitments As of December 31, 2018				
(In thousands)	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**After 5 years**
Contractual obligations:					
Certificates of deposit	$ 2,960,241	$ 1,665,406	$ 965,271	$ 325,945	$ 3,619
Securities sold under agreements to repurchase (1)	150,086	50,086	-	100,000	-
Advances from FHLB	740,000	205,000	335,000	200,000	-
Other borrowings	184,150	-	-	-	184,150
Operating leases	75,628	9,640	16,970	12,574	36,444
Other contractual obligations	69,294	43,722	17,988	3,734	3,850
Total contractual obligations	$ 4,179,399	$ 1,973,854	$ 1,335,229	$ 642,253	$ 228,063
Commitments to sell mortgage loans	$ 6,339				
Standby letters of credit	$ 2,865				
Commitments to extend credit:					
Lines of credit	$ 1,177,854				
Letters of credit	69,664				

Construction undisbursed funds	160,905
Total commercial commitments	$ 1,408,423

(1) Reported net of reverse repurchase agreements by counterparties, when applicable, pursuant to ASC Topic 210-20-45-11.

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

Interest Rate Risk Management

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

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

(1) Using a static balance sheet, as the Corporation had on the simulation date, and

(2) Using a dynamic balance sheet based on recent patterns and current strategies.

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

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

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

As of December 31, 2018, the 12-month net interest income is forecasted assuming the December 31, 2018 interest rate curves remain constant. Then, net interest income is estimated under rising and falling rate scenarios. For the rising rate scenario, a gradual (ramp) parallel upward shift of the yield curve is assumed during the first 12 months (the "+200 ramp" scenario). Conversely, for the falling rate scenario, a gradual (ramp) parallel downward shift of the yield curve is assumed during the first 12 months (the "-200 ramp" scenario). However, given the current low levels of interest rates, a full downward shift of 200 basis points would represent an unrealistic scenario. Therefore, under the falling rate scenario, rates move downward up to 200 basis points, but without reaching zero. The resulting scenario shows interest rates close to zero in most cases, reflecting a flattening yield curve instead of a parallel downward scenario.

The Libor/Swap curve for December 31, 2018, as compared to December 2017, reflected a 99 basis point increase in the short-term horizon, between 1 to 12 months, while market rates increased by 42 basis points in the medium term, that is, between 2 to 5 years. In the long-term, that is, over a 5-year time horizon, market rates increased by 31 basis points, causing a more flattened yield curve. The U.S. Treasury curve in the short-term increased by 103 basis points and in the medium-term horizon increased by 40 basis points as compared to the December 2017 end of month levels. The long-term horizon increased by 29 basis points as compared to December 2017 end of month levels.

The following table presents the results of the simulations as of December 31, 2018 and December 31, 2017. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives:

	December 31, 2018 Net Interest Income Risk (Projected for the next 12 months)				December 31, 2017 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	$ 5.7	1.05%	$ 8.7	1.50%	$ 18.0	3.55%	$ 17.5	3.42%
- 200 bps ramp	$ (7.2)	(1.31)%	$ (9.1)	(1.57)%	$ (14.6)	(2.89)%	$ (17.7)	(3.47)%

The Corporation continues to manage its balance sheet structure to control the overall interest rate risk. As of December 31, 2018, the simulations showed that the Corporation maintained an asset-sensitive position. The Corporation has continued repositioning the balance sheet and improving the funding mix, driven by an increase in the average balance of non-interest-bearing deposits and reductions in brokered CDs, repurchase agreements and other borrowings. The above-mentioned growth in non-interest-bearing deposits, along with proceeds from US agencies mortgage-backed securities and loan repayments, has helped the Corporation continue to maintain high liquidity levels.

Taking into consideration the above-mentioned facts for modeling purposes, the net interest income for the next 12 months under a non-static balance sheet scenario is estimated to increase by $8.7 million in the rising rate scenario when compared against the Corporation’s flat or unchanged interest rate forecast scenario. Under the falling rate, non-static scenario, net interest income is estimated to decrease by $9.1 million.

Derivatives

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

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

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

Forward Contracts - Forward contracts are sales of TBAs that will settle over the standard delivery date and do not qualify as “regular-way” security trades. Regular-way security trades are contracts that have no net settlement provision and no market mechanism to facilitate net settlement and that provide for delivery of a security within the timeframe generally established by regulations or conventions in the market place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked-to-market. These securities are used to economically hedge the FHA/VA residential mortgage loan securitizations of the mortgage-banking operations. Also reported as forward contracts are mandatory mortgage loan sales commitments entered into with GSEs that require or permit net settlement via a pair-off transaction or the payment of a pair-off fee. Unrealized gains (losses) are recognized as part of mortgage banking activities in the consolidated statements of income.

For detailed information regarding the volume of derivative activities (*e.g.*, notional amounts), location and fair values of derivative instruments in the consolidated statements of financial condition and the amount of gains and losses reported in the consolidated statements of income, see Note 33, “Derivative Instruments and Hedging Activities,” of the Corporation’s consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K.

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

(In thousands)	Asset Derivatives Year Ended December 31, 2018		Liability Derivatives Year Ended December 31, 2018	
Fair value of contracts outstanding at the beginning of the year	$	312	$	(324)
Fair value of new contracts entered into during the period		528		(149)
Changes in fair value during the year		178		(527)
Fair value of contracts outstanding as of December 31, 2018	$	1,018	$	(1,000)

Sources of Fair Value

	Maturity 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 December 31, 2018										
Pricing from observable market inputs - Asset Derivatives	$	395	$	529	$	94	$	-	$	1,018
Pricing from observable market inputs - Liability Derivatives		(383)		(529)		(88)		-		(1,000)
	$	12	$	-	$	6	$	-	$	18

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

As of December 31, 2018 and December 31, 2017, all of the derivative instruments held by the Corporation were considered undesignated economic hedges.

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of derivative contracts based on changes in interest rates. The credit risk of derivatives arises from the potential for default of 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.

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 made by the Bank. See "Contractual Obligations, Commitments and Contingencies" above for further details. The credit risk of derivatives arises from the potential that the counterparty will 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, see "Interest Rate Risk Management," above. The Corporation manages its credit risk through its credit policy, underwriting, independent loan review and quality control procedures, statistical analysis, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, personnel performing structured loan workout functions are responsible for mitigating defaults and minimizing losses upon default within each region and for each business segment. In the case of the commercial and industrial ("C&I"), commercial mortgage and construction loan portfolios, the Special Asset Group ("SAG") focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the nonccrual and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary.

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

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

Allowance for Loan and Lease Losses and Non-performing Assets

Allowance for Loan and Lease Losses

The allowance for loan and lease losses represents the estimate of the level of reserves appropriate to absorb inherent incurred credit losses. The amount of the allowance is determined by empirical analysis and judgments regarding the quality of each individual loan portfolio. All known relevant internal and external factors that affect loan collectability are considered, including analyses of historical charge-off experience, migration patterns, changes in economic conditions, and changes in loan collateral values. For example, factors affecting the economies of Puerto Rico, Florida (USA), the USVI and the BVI may contribute to delinquencies and defaults above the Corporation's historical loan and lease losses. Such factors are subject to regular review and may change to reflect updated performance trends and expectations, particularly in times of severe stress. The process includes judgments and quantitative elements that may be subject to significant change.

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

Hurricanes Maria and Irma caused widespread property damage, flooding, power outages, and water and communication services interruptions, and severely disrupted normal economic activity in the affected areas. The methodologies used by the Corporation to determine the hurricane-related qualitative reserve estimates and for the review of individual large commercial credits are discussed in detail in Note 1, "Nature of Business and Summary of Significant Accounting Policies," in the audited consolidated financial statements for the year ended December 31, 2018, which are included in Item 8 of this Form 10-K, and in "Results of Operations – Provision for Loan and Lease Losses" above. With the ongoing collection of information on individual commercial customers and statistics on the consumer and residential loan portfolios, the loss estimate was revised during 2018 and will be revised in the future as needed.

The ratio of the allowance for loan and lease losses to total loans held for investment was 2.22% as of December 31, 2018, compared to 2.62% as of December 31, 2017. The change for each portfolio follows:

- The allowance to total loans ratio for the residential mortgage portfolio decreased from 1.79% as of December 31, 2017 to 1.61% as of December 31, 2018, primarily due to lower nonaccrual and delinquency loan levels.

- The allowance to total loans ratio for the commercial mortgage portfolio increased from 3.00% as of December 31, 2017 to 3.65% as of December 31, 2018, driven by the effect of the downgrade in the credit risk classification of three large loans totaling $110.4 million.

- The allowance to total loans for the C&I portfolio decreased from 2.35% as of December 31, 2017 to 1.52% as of December 31, 2018, reflecting the effect of a $5.5 million net loan loss reserve release related to revised estimates of the qualitative reserve associated with the effects of Hurricanes Maria and Irma, primarily due to updated assessments about the performance and repayment prospects of certain individually assessed commercial loans, charge-offs taken against previously-established reserves, and reserve releases related to the upgrade in the credit risk classification of certain loans.

- The allowance to total loans for the construction loan portfolio increased from 4.06% as of December 31, 2017 to 4.52% as of December 31, 2018, reflecting the effect of the sale in 2018 of a $27.0 million nonaccrual construction loan that carried a specific reserve of $0.6 million as of December 31, 2017.

- The allowance to total loans for the consumer loan portfolio decreased from 4.06% as of December 31, 2017 to 2.77% as of December 31, 2018, reflecting the effect of both $10.9 million of consumer loan charge-offs taken against previously-established hurricane-related qualitative reserves and hurricane-related qualitative reserve releases of $8.4 million resulting from payments received during 2018 that reduced the balance of the consumer loan portfolio outstanding on the dates of the hurricanes and updated payment patterns and credit risk analyses applied to consumer borrowers that were subject to payment deferral programs that expired early in 2018.

The ratio of the total allowance to nonaccrual loans held for investment was 62.15% as of December 31, 2018 compared to 47.36% as of December 31, 2017, reflecting the effect of the $173.6 million decrease in nonaccrual loans held for investment, driven by the aforementioned transfers to held for sale of nonaccrual commercial and construction loans totaling $74.4 million (net of fair value write-downs of $22.2 million), including $57.2 million in nonaccrual commercial mortgage loans that were eventually sold.

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 USVI or BVI or the U.S. mainland (mainly in the state of Florida), the performance of the Corporation's loan portfolio and the value of the collateral supporting the transactions are dependent upon the performance of and conditions within each specific area's real estate market. The real estate market in Puerto Rico experienced readjustments in value driven by reduced demand and general adverse economic conditions that were exacerbated by the effects of Hurricanes Maria and Irma. The Corporation sets adequate loan-to-value ratios following its regulatory and credit policy standards.

As shown in the following table, the allowance for loan and lease losses amounted to $196.4 million as of December 31, 2018, or 2.22% of total loans, compared with $231.8 million, or 2.62% of total loans, as of December 31, 2017. See "Results of Operations - Provision for Loan and Lease Losses" above for additional information.

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

Year Ended December 31,	2018	2017	2016	2015	2014
(Dollars in thousands)					
Allowance for loan and lease losses, beginning of year	$ 231,843	$ 205,603	$ 240,710	$ 222,395	$ 285,858
Provision (release) for loan and lease losses:					
Residential Mortgage (1)	13,202	50,744	25,090	30,377	17,487
Commercial Mortgage (2)	23,074	30,054	8,688	66,884	(7,076)
Commercial and Industrial (3)	(8,440)	1,018	17,075	34,575	36,681
Construction (4)	7,032	4,835	497	(6,891)	(17,508)
Consumer and Finance Leases (5)	24,385	57,603	35,383	47,100	79,946
Total provision for loan and lease losses (6)	59,253	144,254	86,733	172,045	109,530
Charge-offs:					
Residential Mortgage	(24,775)	(28,186)	(33,621)	(19,317)	(24,345)
Commercial Mortgage	(23,911)	(39,092)	(20,454)	(56,101)	(25,807)
Commercial and Industrial	(9,704)	(19,855)	(26,579)	(33,844)	(61,935)
Construction	(8,296)	(3,607)	(1,770)	(4,994)	(11,533)
Consumer and Finance Leases	(50,106)	(44,030)	(54,504)	(62,465)	(76,696)
Total charge offs	(116,792)	(134,770)	(136,928)	(176,721)	(200,316)
Recoveries:					
Residential Mortgage	3,392	2,437	2,941	1,209	1,049
Commercial Mortgage	7,925	270	816	6,534	10,639
Commercial and Industrial	1,819	5,755	2,689	4,316	3,680
Construction	334	732	316	2,582	6,049
Consumer and Finance Leases	8,588	7,562	8,326	8,350	5,906
Total recoveries	22,058	16,756	15,088	22,991	27,323
Net charge-offs	(94,734)	(118,014)	(121,840)	(153,730)	(172,993)
Allowance for loan and lease losses, end of year	$ 196,362	$ 231,843	$ 205,603	$ 240,710	$ 222,395
Allowance for loan and lease losses to year-end total loans held for investment	2.22%	2.62%	2.31%	2.64%	2.44%
Net charge-offs (annualized) to average loans outstanding during the year	1.09%	1.33%	1.37%	1.68%	1.84%
Provision for loan and lease losses to net charge-offs during the year	0.63x	1.22x	0.71x	1.12x	0.63x
Provision for loan and lease losses to net charge-offs during the year, excluding the effect of the hurricane-related reserve releases/charges in 2018 and 2017 (7)	0.80x	0.62x	0.71x	1.12x	0.63x

(1) Net of a $0.4 million net loan loss reserve release for the year ended December 31, 2018 associated with revised estimates of the effects of Hurricanes Irma and Maria. For the year ended December 31, 2017, includes a charge to the provision of $14.6 million associated with the effects of Hurricanes Irma and Maria.

(2) Net of a $1.9 million net loan loss reserve release for the year ended December 31, 2018 associated with revised estimates of the effects of Hurricanes Irma and Maria. For the year ended December 31, 2017, includes

a charge to the provision of $12.1 million associated with the effects of Hurricanes Irma and Maria.

(3) Net of a $5.5 million net loan loss reserve release for the year ended December 31, 2018 associated with revised estimates of the effects of Hurricanes Irma and Maria. For the year ended December 31, 2017, includes a charge to the provision of $15.9 million associated with the effects of Hurricanes Irma and Maria.

(4) Net of a $0.7 million net loan loss reserve release for the year ended December 31, 2018 associated with revised estimates of the effects of Hurricanes Irma and Maria. For the year ended December 31, 2017, includes a charge to the provision of $3.7 million associated with the effects of Hurricanes Irma and Maria.

(5) Net of an $8.4 million net loan loss reserve release for the year ended December 31, 2018 associated with revised estimates of the effects of Hurricanes Irma and Maria. For the year ended December 31, 2017, includes a charge to the provision of $25.0 million associated with the effects of Hurricanes Irma and Maria.

(6) Net of a $16.9 million net loan loss reserve release for the year ended December 31, 2018 associated with revised estimates of the effects of Hurricanes Irma and Maria. For the year ended December 31, 2017, includes a provision of $71.3 million associated with the effects of Hurricanes Irma and Maria.

(7) Non-GAAP financial measure, see "Basis of Presentation" below for a reconciliation of this measure.

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

As of December 31,	**2018**		**2017**		**2016**		**2015**		**20**
	Amount	**Percent of loans in each category to total loans**	**Amount**	**Percent of loans in each category to total loans**	**Amount**	**Percent of loans in each category to total loans**	**Amount**	**Percent of loans in each category to total loans**	**Amount**
(Dollars in thousands)									
Residential mortgage loans	$ 50,794	36%	$ 58,975	37%	$ 33,980	37%	$ 39,570	36%	$ 27,30
Commercial mortgage loans	55,581	17%	48,493	18%	57,261	18%	68,211	17%	50,89
Construction loans	3,592	1%	4,522	1%	2,562	1%	3,519	2%	12,82
Commercial and Industrial	32,546	24%	48,871	24%	61,953	25%	68,768	25%	63,72
Consumer loans and finance leases	53,849	22%	70,982	20%	49,847	19%	60,642	20%	67,65
	$ 196,362	100%	$ 231,843	100%	$ 205,603	100%	$ 240,710	100%	$ 222,395

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The following table sets forth information concerning the composition of the Corporation's allowance for loan and lease losses as of December 31, 2018 and 2017 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance:

As of December 31, 2018 (Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**Commercial and Industrial Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	$ 110,238	$ 43,358	$ 30,030	$ 2,431	$ 2,340	$ 188,397
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs	293,494	184,068	61,162	4,162	28,986	571,872
Allowance for loan and lease losses	19,965	17,684	9,693	760	5,874	53,976
Allowance for loan and lease losses to principal balance	6.80%	9.61%	15.85%	18.26%	20.26%	9.44
PCI loans:						
Carrying value of PCI loans	143,176	3,464	-	-	-	146,640
Allowance for PCI loans	10,954	400	-	-	-	11,354
Allowance for PCI loans to carrying value	7.65%	11.55%	-	-	-	7.74
Loans with general allowance:						
Principal balance of loans	2,616,300	1,291,772	2,056,919	72,836	1,913,387	7,951,214
Allowance for loan and lease losses	19,875	37,497	22,853	2,832	47,975	131,032
Allowance for loan and lease losses to principal balance	0.76%	2.90%	1.11%	3.89%	2.51%	1.65
Total loans held for investment:						
Principal balance of loans	$ 3,163,208	$ 1,522,662	$ 2,148,111	$ 79,429	$ 1,944,713	$ 8,858,123
Allowance for loan and lease losses	50,794	55,581	32,546	3,592	53,849	196,362
Allowance for loan and lease losses to principal balance (1)	1.61%	3.65%	1.52%	4.52%	2.77%	2.22

(Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**Commercial and Industrial Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
As of December 31, 2017						
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	$ 116,818	$ 65,100	$ 28,292	$ 48	$ 2,788	$ 213,04
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs	316,616	87,814	90,008	47,218	35,606	577,26
Allowance for loan and lease losses	22,086	9,783	12,359	2,017	5,165	51,41
Allowance for loan and lease losses to principal balance	6.98%	11.14%	13.73%	4.27%	14.51%	8.9

PCI loans:						
Carrying value of PCI loans	153,991	4,183	-	-	-	158,17
Allowance for PCI loans	10,873	378	-	-	-	11,25
Allowance for PCI loans to carrying value	7.06%	9.04%	-	-	-	7.1
Loans with general allowance:						
Principal balance of loans	2,703,532	1,457,875	1,964,953	64,131	1,711,503	7,901,99
Allowance for loan and lease losses	26,016	38,332	36,512	2,505	65,817	169,18
Allowance for loan and lease losses to principal balance	0.96%	2.63%	1.86%	3.91%	3.85%	2.1
Total loans held for investment:						
Principal balance of loans	$ 3,290,957	$ 1,614,972	$ 2,083,253	$ 111,397	$ 1,749,897	$ 8,850,47
Allowance for loan and lease losses	58,975	48,493	48,871	4,522	70,982	231,84
Allowance for loan and lease losses to principal balance (1)	1.79%	3.00%	2.35%	4.06%	4.06%	2.6

(1) Loans used in the denominator include PCI loans of $146.6 million and $158.2 million as of December 31, 2018 and 2017, respectively. However, the Corporation separately tracks and reports PCI loans and excludes these loans from the amounts of nonaccrual loans, impaired loans, TDRs and non-performing assets.

The following table show the activity for impaired loans held for investment during 2018, 2017 and 2016:

	2018	2017	2016
(In thousands)			
Impaired Loans:			
Balance at beginning of year	$ 790,308	$ 887,905	$ 806,509
Loans determined impaired during the year	250,524	140,977	288,202
Charge-offs (1)	(57,152)	(82,113)	(67,210)
Loans sold, net of charge-offs	(4,121)	(53,245)	(8,675)
Increases to existing impaired loans	7,335	8,292	3,236
Foreclosures	(36,453)	(37,513)	(36,161)
Loans no longer considered impaired	(5,417)	(3,526)	(27,643)
Loans transferred to held for sale	(74,052)	-	-
Paid in full or partial payments	(110,703)	(70,469)	(70,353)
Balance at end of year	$ 760,269	$ 790,308	$ 887,905

(1) For the year ended December 31, 2018, includes charge-offs totaling $22.2 million associated with the $74.4 million in nonaccrual loans transferred to held for sale during 2018. For the year ended December 31, 2017, includes a charge-off of $10.7 million associated with the sale of the PREPA credit line, and for the year ended December 31, 2016, includes $4.2 million of charge-offs related to impaired loans included in the sale of the $16.3 million pool of non-performing assets.

Nonaccrual loans and Non-performing Assets

Total non-performing assets consist of nonaccrual loans (generally loans held for investment or loans held for sale on which the recognition of interest income has been discontinued when the loan became 90 days past due or earlier if the full and timely collection of interest or principal is uncertain), foreclosed real estate and other repossessed properties, and non-performing investment securities. When a loan is placed in nonaccrual status, any interest previously recognized and not collected is reversed and charged against interest income. Cash payments received on certain loans that are impaired and collateral-dependent are recognized when collected in accordance with the contractual terms of the loans. The principal portion of the payment is used to reduce the principal balance of the loan, whereas the interest portion is recognized on a cash basis (when collected). However, when management believes that the ultimate collectability of principal is in doubt, the interest portion is applied to the outstanding 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.

Nonaccrual Loans Policy

Residential Real Estate Loans — The Corporation classifies real estate loans in nonaccrual 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 nonaccrual status when interest and principal have not been received for a period of 90 days or more or when collection of all of the principal or interest is not expected due to deterioration in the financial condition of the borrower.

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

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

Purchased Credit Impaired Loans — PCI loans were recorded at fair value at acquisition. Since the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the subsequent accounting for PCI loans differs from the accounting for non-PCI loans. The Corporation, therefore, separately tracks and reports PCI loans and excludes these from the amounts of nonaccrual loans, impaired loans, TDR loans, and non-performing assets.

Other Real Estate Owned

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

Other Repossessed Property

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

Other Non-Performing Assets

This category consisted of bonds of the GDB and the Puerto Rico Public Buildings Authority prior to the sale of these non-performing bonds in the second quarter of 2017. These bonds were previously held by the Corporation as part of its available-for-sale investment securities portfolio.

Past-Due Loans 90 days and still accruing

These are accruing loans that are contractually delinquent 90 days or more. These past-due loans are either current as to interest but delinquent as to the payment of principal or are insured or guaranteed under applicable FHA, VA or other government-guaranteed programs for residential mortgage loans. Past due loans 90 days and still accruing also include PCI loans with individual delinquencies over 90 days, primarily related to mortgage loans acquired from Doral Bank in 2015 and from Doral Financial in 2014.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may

result in the loans being returned to accrual status at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan.

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

	December 31, 2018	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014
(Dollars in thousands)					
Nonaccrual loans held for investment:					
Residential mortgage	$ 147,287	$ 178,291	$ 160,867	$ 169,001	$ 180,707
Commercial mortgage (1)	109,536	156,493	178,696	51,333	148,473
Commercial and industrial (1)	30,382	85,839	146,599	137,051	122,547
Construction (1)	8,362	52,113	49,852	54,636	29,354
Finance leases	1,329	1,237	1,335	2,459	5,245
Consumer	19,077	15,581	22,745	28,293	37,570
Total nonaccrual loans held for investment (1)	315,973	489,554	560,094	442,773	523,896
OREO	131,402	147,940	137,681	146,801	124,003
Other repossessed property	3,576	4,802	7,300	12,223	14,229
Other non-performing assets (2)	-	-	21,362	-	-
Total non-performing assets, excluding loans held for sale	450,951	642,296	726,437	601,797	662,128
Nonaccrual loans held for sale (1)	16,111	8,290	8,079	8,135	54,641
Total non-performing assets, including nonaccrual loans held for sale (3)(4)	$ 467,062	$ 650,586	$ 734,516	$ 609,932	$ 716,769
Past due loans 90 days and still accruing (5) (6)	$ 158,527	$ 160,725	$ 135,808	$ 163,197	$ 162,887
Non-performing assets to total assets	3.81%	5.31%	6.16%	4.85%	5.63%
Nonaccrual loans held for investment to total loans held for investment	3.57%	5.53%	6.30%	4.86%	5.76%
Allowance for loan and lease losses	$ 196,362	$ 231,843	$ 205,603	$ 240,710	$ 222,395

Allowance to total nonaccrual loans held for investment	62.15%	47.36%	36.71%	54.36%	42.45%
Allowance to total nonaccrual loans held for investment, excluding residential real estate loans	116.41%	74.48%	51.50%	87.92%	64.80%

(1) During the first and third quarters 2018, the Corporation transferred $74.4 million (net of fair value write-downs of $22.2 million recorded at the time of transfers) in nonaccrual loans to held for sale. Loans transferred to held for sale consisted of nonaccrual commercial mortgage loans totaling $39.6 million (net of fair value write-downs of $13.8 million), nonaccrual construction loans totaling $33.0 million (net of fair value write-downs of $6.7 million) and nonaccrual commercial and industrial loans totaling $1.8 million (net of fair value write-downs of $1.7 million). Approximately $27.2 million of the commercial mortgage loans transferred to loans held for sale and $30.0 million of the construction loans transferred to loans held for sale were eventually sold during the second, third and fourth quarters of 2018.

(2) Fair market value of bonds of the GDB and the Puerto Rico Public Buildings Authority prior to the sale completed during the second quarter of 2017.

(3) PCI loans accounted for under ASC Topic 310-30 of $146.6 million, $158.2 million, $165.8 million, $173.9 million and $102.6 million as of December 31, 2018, 2017, 2016, 2015 and 2014, respectively, are excluded and not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

(4) Nonaccrual loans exclude $478.9 million, $374.7 million, $384.9 million, $414.9 million and $494.6 million of TDR loans that were in compliance with the modified terms and in accrual status as of December 31, 2018, 2017, 2016, 2015 and 2014, respectively.

(5) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to nonaccrual loans since the principal repayment is insured. These balances include $51.4 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 15 months delinquent, and are no longer accruing interest as of December 31, 2018, taking into consideration the FHA interest curtailment process.

(6) Amount includes PCI loans with individual delinquencies over 90 days and still accruing with a carrying value as of December 31, 2018, 2017, 2016, 2015, and 2014 of approximately $29.4 million, $29.3 million, $29.0 million, $23.2 million, and $15.7 million, respectively, primarily related to loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014.

The following table shows non-performing assets by geographic segment as of the indicated dates:

(Dollars in thousands)	December 31, 2018	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014
Puerto Rico:					
Nonaccrual loans held for investment:					
Residential mortgage	$ 120,707	$ 147,852	$ 135,863	$ 147,975	$ 156,361
Commercial mortgage (1)	44,925	128,232	167,241	34,917	121,879
Commercial and industrial (2)	26,005	79,809	141,916	131,450	116,301
Construction (3)	6,220	14,506	10,227	11,894	24,526
Finance leases	1,329	1,237	1,335	2,459	5,245
Consumer	18,037	14,885	21,592	26,329	35,286
Total nonaccrual loans held for investment	217,223	386,521	478,174	355,024	459,598
OREO	124,124	140,063	128,395	133,121	111,041
Other repossessed property	3,357	4,723	7,217	12,115	14,150
Other non-performing assets (4)	-	-	21,362	-	-
Total non-performing assets, excluding nonaccrual loans held for sale	344,704	531,307	635,148	500,260	584,789
Nonaccrual loans held for sale (1) (2) (3)	16,111	8,290	8,079	8,135	14,636
Total non-performing assets, including nonaccrual loans held for sale (5)	$ 360,815	$ 539,597	$ 643,227	$ 508,395	$ 599,425
Past-due loans 90 days and still accruing (6)	$ 153,269	$ 151,724	$ 131,783	$ 154,915	$ 154,375
Virgin Islands:					
Nonaccrual loans held for investment:					
Residential mortgage	$ 12,106	$ 22,110	$ 19,860	$ 14,228	$ 15,483
Commercial mortgage	19,368	25,309	7,617	10,073	11,770
Commercial and industrial	4,377	6,030	4,683	5,601	6,246
Construction (7)	2,142	37,607	39,625	42,590	4,064
Consumer	710	281	452	471	887
Total nonaccrual loans held for investment	38,703	91,337	72,237	72,963	38,450
OREO	6,704	6,306	6,216	5,458	6,967
Other repossessed property	76	26	5	32	22
Total non-performing assets, excluding					

nonaccrual loans held for sale	$	45,483	$	97,669	$	78,458	$	78,453	$	45,439
Nonaccrual loans held for sale [(7) (8)]		-		-		-		-		40,005
Total non-performing assets, including nonaccrual loans held for sale	$	45,483	$	97,669	$	78,458	$	78,453	$	85,444
Past-due loans 90 days and still accruing	$	5,258	$	9,001	$	2,133	$	8,173	$	5,281
United States:										
Nonaccrual loans held for investment:										
Residential mortgage	$	14,474	$	8,329	$	5,144	$	6,798	$	8,863
Commercial mortgage		45,243		2,952		3,838		6,343		14,824
Construction		-		-		-		152		764
Consumer		330		415		701		1,493		1,397
Total nonaccrual loans held for investment		60,047		11,696		9,683		14,786		25,848
OREO		574		1,571		3,070		8,222		5,995
Other repossessed property		143		53		78		76		57
Total non-performing assets	$	60,764	$	13,320	$	12,831	$	23,084	$	31,900
Past-due loans 90 days and still accruing	$	-	$	-	$	1,892	$	109	$	3,231

(1) During 2018, the Corporation transferred to held for sale nonaccrual commercial mortgage loans in Puerto Rico totaling $39.6 million (net of fair value write-downs of $13.8 million recorded at the time of transfers). Approximately $27.2 million of the commercial mortgage loans transferred to held for sale were eventually sold during the second and third quarters of 2018.

(2) During 2018, the Corporation transferred to held for sale nonaccrual commercial and industrial loans in Puerto Rico totaling $1.8 million (net of fair value write-downs of $1.7 million).

(3) During 2018, the Corporation transferred to held for sale a $3.0 million nonaccrual construction loan in Puerto Rico (net of a $1.6 million fair value write-down).

(4) Fair market value of bonds of the GDB and the Puerto Rico Public Buildings Authority prior to the sale completed during the second quarter of 2017.

(5) PCI loans accounted for under ASC Topic 310-30 of $146.6 million, $158.2 million, $165.8 million, $173.9 million and $102.6 million as of December 31, 2018, 2017, 2016, 2015 and 2014, respectively, are excluded and not considered nonaccrual due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

(6) Amount includes PCI loans with individual delinquencies over 90 days and still accruing with a carrying value as of December 31, 2018, 2017, 2016, 2015, and 2014 of approximately $29.4 million, $29.3 million, $29.0 million, $23.2 million, and $15.7 million, respectively, primarily related to loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014.

(7) During 2018, the Corporation transferred to held for sale a $30.0 million nonaccrual construction loan in the Virgin Islands (net of a $5.1 million fair value write-down). The construction loans transferred to held for sale was eventually sold during the fourth quarter of 2018.

Total nonaccrual loans, including nonaccrual loans held for sale, were $332.1 million as of December 31, 2018. This represents a decrease of $165.7 million from $497.8 million as of December 31, 2017. The decrease in nonaccrual loans was primarily attributable to: (i) the restoration to accrual status of two large commercial loans totaling $69.7 million, including a $34 million commercial mortgage loan that was restructured through a loan split in the second quarter of 2018 and paid off during the fourth quarter of 2018; (ii) sales of nonaccrual commercial and construction loans held for sale of $61.9 million; (iii) collections on commercial and construction nonaccrual loans of $32.3 million; (iv) commercial and construction nonaccrual loan charge-offs totaling $40.3 million; and (v) a $31.0 million decrease in residential nonaccrual loans. These variances were partially offset by the inflow of two large commercial mortgage loans totaling $69.8 million related to a legacy commercial loan relationship that operates in both the Florida and Puerto Rico regions with independent sources of repayment.

Nonaccrual commercial mortgage loans, including nonaccrual commercial mortgage loans held for sale, decreased by $35.6 million to $120.9 million as of December 31, 2018 from $156.5 million as of December 31, 2017. The decrease was primarily related to the aforementioned $34 million commercial mortgage loan restructured and paid off in 2018, sales of $27.2 million of nonaccrual commercial mortgage loans, collections on nonaccrual commercial mortgage loans of $17.5 million, and commercial mortgage nonaccrual loan charge-offs of $23.8 million. These variances were partially offset by the aforementioned inflow in 2018 of two large commercial mortgage loans totaling $69.8 million related to a legacy commercial loan relationship that operates in both the Florida and Puerto Rico regions. Total inflows of nonaccrual commercial mortgage loans held for investment amounted to $78.6 million during 2018, compared to $55.8 million in 2017.

Nonaccrual C&I loans, including nonaccrual C&I loans held for sale, decreased by $53.7 million to $32.1 million as of December 31, 2018 from $85.8 million as of December 31, 2017. The decrease was primarily related to the restoration to accrual status of a $35.7 million commercial and industrial loan as the borrower had demonstrated sustained performance for an extended period and principal and interest is deemed fully collectible, collections on nonaccrual commercial and industrial loans of $9.0 million, and commercial and industrial nonaccrual loan charge-offs of $8.2 million. Total inflows of nonaccrual C&I loans held for investment were $5.2 million during 2018, compared to $25.6 million in 2017.

Nonaccrual construction loans, including nonaccrual construction loans held for sale, decreased by $49.0 million to $11.4 million as of December 31, 2018 from $60.4 million as of December 31, 2017. The decrease was primarily due to the sale of $34.7 million of nonaccrual construction loans, construction nonaccrual loan charge-offs of $8.3 million, and collections on nonaccrual construction loans of $4.8 million. Total inflows of nonaccrual construction loans held for investment amounted to $1.7 million during 2018, compared to $10.1 million in 2017.

The following tables present the activity of commercial and construction nonaccrual loans held for investment:

	Commercial Mortgage	Commercial & Industrial	Construction	Total

(In thousands)				
Year ended December 31, 2018				
Beginning balance	$ 156,493	$ 85,839	$ 52,113	$ 294,445
Plus:				
Additions to nonaccrual	78,564	5,178	1,659	85,401
Less:				
Loans returned to accrual status	(40,225)	(37,869)	(899)	(78,993)
Nonaccrual loans transferred to OREO	(4,353)	(3,841)	(676)	(8,870)
Nonaccrual loans charge-offs	(23,818)	(8,199)	(8,262)	(40,279)
Loan collections	(17,539)	(8,936)	(1,777)	(28,252)
Reclassification	-	-	(781)	(781)
Loans transferred to loans held for sale, net of charge-offs	(39,586)	(1,790)	(33,015)	(74,391)
Ending balance	$ 109,536	$ 30,382	$ 8,362	$ 148,280

(In thousands)	Commercial Mortgage	Commercial & Industrial	Construction	Total
Year ended December 31, 2017				
Beginning balance	$ 178,696	$ 146,599	$ 49,852	$ 375,147
Plus:				
Additions to nonaccrual	55,847	25,598	10,110	91,555
Less:				
Loans returned to accrual status	(2,787)	(1,254)	(111)	(4,152)
Nonaccrual loans transferred to OREO	(9,039)	(4,263)	(342)	(13,644)
Nonaccrual loans charge-offs	(38,588)	(19,592)	(3,607)	(61,787)
Loan collections	(27,750)	(8,984)	(3,389)	(40,123)
Reclassification	114	980	(400)	694
Nonaccrual loans sold, net of charge-offs	-	(53,245)	-	(53,245)
Ending balance	$ 156,493	$ 85,839	$ 52,113	$ 294,445

The following table presents the activity of commercial and construction nonaccrual loans held for sale:

(In thousands)	Commercial Mortgage	Commercial & Industrial	Construction	Total
Year ended December 31, 2018				
Beginning balance	$ -	$ -	$ 8,290	$ 8,290
Plus:				
Loans transferred from held for investment	39,586	1,790	33,015	74,391
Less:				
Loan collections	(1,001)	(65)	(3,000)	(4,066)
Lower of cost or market adjustment	-	-	(558)	(558)
Nonaccrual loans sold	(27,214)	-	(34,732)	(61,946)
Ending balance	$ 11,371	$ 1,725	$ 3,015	$ 16,111

(In thousands)	Construction
Year ended December 31, 2017	
Beginning balance	$ 8,079

Plus:		
Increase to existing construction loans held for sale		211
Ending balance	$	8,290

Total nonaccrual commercial and construction loans, including nonaccrual loans held for sale, with a book value of $164.4 million as of December 31, 2018 were being carried (net of reserves and accumulated charge-offs) at 56.1% of unpaid principal balance.

Nonaccrual residential mortgage loans decreased by $31.0 million to $147.3 million as of December 31, 2018 from $178.3 million as of December 31, 2017. The decrease was driven primarily by loans brought current, loans transferred to the OREO portfolio, and collections and charge-offs recorded during 2018, partially offset by inflows.

The following table presents the activity of residential nonaccrual loans held for investment in 2018 and 2017:

		Year ended December 31, 2018		Year ended December 31, 2017
(In thousands)				
Beginning balance	$	178,291	$	160,867
Plus:				
Additions to nonaccrual		76,176		103,144
Less:				
Loans returned to accrual status		(44,782)		(33,322)
Nonaccrual loans transferred to OREO		(30,079)		(25,429)
Nonaccrual loans charge-offs		(17,511)		(18,718)
Loan collections		(15,589)		(7,557)
Reclassification		781		(694)
Ending balance	$	147,287	$	178,291

The amount of nonaccrual consumer loans, including finance leases, increased by $3.6 million during 2018 to $20.4 million, compared to $16.8 million as of December 31, 2017. The inflows of nonaccrual consumer loans during 2018 were $53.8 million, an increase of $15.3 million, compared to inflows of $38.5 million in 2017. Higher inflows reflect the effect in 2017 of the three-month payment deferral program to hurricane-affected consumer borrowers.

As of December 31, 2018, approximately $36.3 million of the loans placed in non-accrual status, mainly commercial loans, were current, or had delinquencies of less than 90 days in their principal and interest payments, including $17.7 million of TDRs maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability. Collections on these loans are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the year ended December 31, 2018, interest income of approximately $4.4 million related to nonaccrual loans with a carrying value of $81.7 million as of December 31, 2018, mainly nonaccrual construction and commercial loans, was applied against the related principal balances under the cost-recovery method.

As of December 31, 2018, approximately $108.6 million, or 34.4%, of total nonaccrual loans held for investment have been charged-off to their net realizable value and no specific reserve was allocated as shown in the following table:

(Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**Commercial & Industrial Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
As of December 31, 2018						
Nonaccrual loans held for investment charged-off to realizable value	$ 60,648	$ 36,386	$ 8,440	$ 2,431	$ 675	$ 108,580
Other nonaccrual loans held for investment	86,639	73,150	21,942	5,931	19,731	207,393
Total nonaccrual loans held for investment	$ 147,287	$ 109,536	$ 30,382	$ 8,362	$ 20,406	$ 315,973
Allowance to nonaccrual loans held for investment	34.49%	50.74%	107.12%	42.96%	263.89%	62.15 %
Allowance to nonaccrual loans held for investment, excluding nonaccrual loans charged off to realizable value	58.63%	75.98%	148.33%	60.56%	272.92%	94.68%
As of December 31, 2017						
Nonaccrual loans held for investment charged-off to realizable value	$ 76,668	$ 60,680	$ 6,872	$ 48	$ 843	$ 145,111

Other nonaccrual loans held for investment	101,623	95,813	78,967	52,065	15,975	344,443
Total nonaccrual loans held for investment	$ 178,291	$ 156,493	$ 85,839	$ 52,113	$ 16,818	$ 489,554
Allowance to nonaccrual loans held for investment	33.08%	30.99%	56.93%	8.68%	422.06%	47.36 %
Allowance to nonaccrual loans held for investment, excluding nonaccrual loans charged-off to realizable value	58.03%	50.61%	61.89%	8.69%	444.33%	67.31%

Total loans in early delinquency (*i.e.*, 30-89 days past due loans, as defined in regulatory report instructions) amounted to $136.6 million as of December 31, 2018, a decrease of $108.1 million compared to $244.7 million as of December 31, 2017. The variances by major portfolio categories is as follow:

- Consumer loans in early delinquency decreased by $51.7 million to $59.5 million as of December 31, 2018, compared to $111.2 million as of December 31, 2017, and residential mortgage loans in early delinquency decreased by $42.7 million to $73.2 million as of December 31, 2018, from $115.9 million as of December 31, 2017. These variances primarily reflect both the resumption of payments by clients after the expiration of the three-month payment deferral programs offered to hurricane-affected borrowers and the classification of loans as non-performing during 2018.

- Commercial and construction loans in early delinquency decreased by $13.8 million to $3.9 million as of December 31, 2018, compared to $17.7 million as of December 31, 2017, primarily due to loans brought current.

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program, as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans, fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include, among others, the extension of the maturity of the loan and modifications of the loan rate. See Note 8, "Loans Held for Investment," in the audited consolidated financial statements for the year ended December 31, 2018, which are included in Item 8 of this Form 10-K, for additional information and statistics about the Corporation's TDR loans.

TDR loans are classified as either accrual or nonaccrual loans. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loans had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, loans on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can, and are likely to, continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation's interest income by returning a nonaccrual loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and limit increases in foreclosure and OREO costs.

The following table provides a breakdown between accrual and nonaccrual TDRs:

(In thousands)	As of December 31, 2018		
	Accrual	**Nonaccrual** [1]	**Total TDRs**

Non-FHA/VA Residential Mortgage loans	$ 271,766	$ 62,136	$ 333,902
Commercial Mortgage loans (2)	116,830	21,119	137,949
Commercial and Industrial loans (3)	66,603	8,318	74,921
Construction loans			
Construction - Land	1,071	3,694	4,765
Construction - Commercial	-	-	-
Construction - Residential	-	762	762
Consumer loans - Auto	11,842	6,189	18,031
Finance leases	1,791	144	1,935
Consumer loans - Other	9,025	1,357	10,382
Total Troubled Debt Restructurings	$ 478,928	$ 103,719	$ 582,647

(1)Included in nonaccrual loans are $17.7 million in loans that are performing under the terms of the restructuring agreement but are reported in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and are deemed fully collectible.
(2)Excludes commercial mortgage TDR loans held for sale amounting to $11.1 million as of December 31, 2018.
(3)Excludes commercial and industrial TDR loans held for sale amounting to $0.9 million as of December 31, 2018.

The OREO portfolio, which is part of non-performing assets, decreased by $16.5 million to $131.4 million as of December 31, 2018 from $147.9 million as of December 31, 2017. The following tables show the composition of the OREO portfolio as of December 31, 2018 and December 31, 2017, as well as the activity during the year ended December 31, 2018 of the OREO portfolio by geographic region:

OREO Composition by Region

(In thousands)	As of December 31, 2018			
	Puerto Rico	**Virgin Islands**	**Florida**	**Consolidated**
Residential	$ 47,428	$ 1,369	$ 442	$ 49,239
Commercial	67,185	4,521	132	71,838
Construction	9,511	814	-	10,325
	$ 124,124	$ 6,704	$ 574	$ 131,402

(In thousands)	As of December 31, 2017			
	Puerto Rico	**Virgin Islands**	**Florida**	**Consolidated**
Residential	$ 52,427	$ 514	$ 1,440	$ 54,381
Commercial	77,812	4,927	132	82,871
Construction	9,823	865	-	10,688
	$ 140,062	$ 6,306	$ 1,572	$ 147,940

OREO Activity by Region

(In thousands)	For the year ended December 31, 2018			
	Puerto Rico	**Virgin Islands**	**Florida**	**Consolidated**
Beginning Balance	$ 140,062	$ 6,306	$ 1,572	$ 147,940
Additions	48,097	1,464	1,061	50,622
Sales	(41,837)	(368)	(2,016)	(44,221)
Fair value adjustments and impairments	(22,198)	(698)	(43)	(22,939)
Ending Balance	$ 124,124	$ 6,704	$ 574	$ 131,402

Net Charge-offs and Total Credit Losses

Net charge-offs totaled $94.7 million in 2018, or 1.09% of average loans, compared to $118.0 million, or 1.33%, in 2017. Net charge-offs for 2018 included charge-offs totaling $22.2 million associated with the transfer to held for sale of $74.4 million in nonaccrual commercial and construction loans. Net charge-offs for 2017 included a $10.7 million charge-off associated with the sale of the PREPA credit line.

Commercial mortgage loan net charge-offs in 2018 were $16.0 million, or 1.03% of average commercial mortgage loans, compared to $38.8 million, or 2.42%, for 2017. Commercial mortgage loan net charge-offs during 2018 included $13.8 million associated with the transfer to held for sale of $39.6 million in nonaccrual commercial mortgage loans. In addition, the Corporation recorded a loan loss recovery of $7.4 million in 2018 on a commercial mortgage loan paid off compared to charge-offs of $27.3 million taken on such loan in 2017.

Commercial and Industrial loan net charge-offs for 2018 totaled $7.9 million, or 0.38% of average commercial and industrial loans, compared to $14.1 million, or 0.66%, for 2017. Commercial and Industrial loan net charge-offs for 2018 included $1.7 million associated with the transfer to held for sale of $1.8 million in nonaccrual loans. Commercial and Industrial loan net charge-offs for 2017 included the $10.7 million charge-off associated with the sale of the PREPA credit line.

Construction loans net charge-offs for 2018 were $8.0 million, or 6.75% of average construction loans, compared to net charge-offs of $2.9 million, or 2.05%, for 2017. The variance was primarily related to charge-offs totaling $6.7 million related to $33.0 million in nonaccrual construction loans transferred to held for sale during 2018.

Residential mortgage loans net charge-offs for 2018 were $21.4 million, or 0.67% of average residential mortgage loans, compared to $25.7 million, or 0.79%, for 2017. Approximately $16.9 million in charge-offs for 2018 resulted from valuations for impairment purposes of residential mortgage loans considered homogeneous given high delinquency and loan-to-value levels compared to $17.7 million for 2017. Net charge-offs on residential mortgage loans also included $3.7 million related to foreclosures during 2018, compared to $6.6 million for 2017.

Net charge-offs of consumer loans and finance leases for 2018 were $41.5 million, or 2.31% of average consumer loans and finance leases, compared to $36.5 million, or 2.12% of average loans, in 2017. The increase primarily reflects adjustments in the auto loan portfolio and hurricane-related charge-offs taken on credit cards during 2018. Approximately $10.9 million of the consumer loan charge-offs recorded in 2018 were taken against previously-established hurricane-related qualitative reserves associated with Hurricanes Irma and Maria.

The following table shows the ratios of net charge-offs to average loans by loan category for the last five years.

	For the year ended December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
Residential mortgage	0.67%	0.79%	0.93%	0.55%	0.85%
Commercial mortgage	1.03%	2.42%	1.28%	3.12%	0.84%
Commercial and Industrial	0.38%	0.66%	1.11%	1.32%	2.27%
Construction	6.75%	2.05%	1.02%	1.42%	2.76%
Consumer loans and finance leases	2.31%	2.12%	2.63%	2.85%	3.46%
Total loans	1.09%	1.33%	1.37%	1.68%	1.84%

The following table presents net charge-offs to average loans held in various portfolios by geographic segment for the last five years:

	December 31, 2018	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014
PUERTO RICO:					
Residential mortgage	0.86%	1.05%	1.20%	0.70%	1.08%
Commercial mortgage	1.23%	3.36%	1.66%	3.90%	1.72%
Commercial and Industrial	0.56%	0.96%	1.47%	1.63%	2.68%
Construction	6.18%	6.38%	2.93%	5.33%	4.16%
Consumer and finance leases	2.31%	2.14%	2.73%	2.96%	3.58%
Total loans	1.28%	1.74%	1.71%	2.05%	2.32%
VIRGIN ISLANDS:					
Residential mortgage	0.48%	0.11%	0.15%	0.04%	0.19%
Commercial mortgage (1)	(0.14)%	(0.13)%	(0.16)%	-%	0.10%
Commercial and Industrial (2)	0.16%	(0.01)%	(0.01)%	0.23%	(0.23)%
Construction (3)	14.00%	(0.99)%	0.25%	0.21%	6.71%
Consumer and finance leases	2.70%	1.77%	1.04%	0.29%	0.58%
Total loans	1.49%	0.10%	0.16%	0.11%	0.81%
FLORIDA:					
Residential mortgage	0.02%	0.04%	0.04%	0.03%	0.03%
Commercial mortgage (4)	0.72%	(0.01)%	(0.03)%	0.26%	(3.12)%
Commercial and Industrial (5)	0.01%	-%	(0.01)%	-%	-%
Construction (6)	(0.84)%	(0.74)%	(1.03)%	(5.98)%	(14.75)%
Consumer and finance leases	1.75%	1.69%	0.70%	1.11%	0.73%
Total loans (7)	0.22%	0.06%	0.01%	(0.04)%	(1.37)%

(1) For 2018, 2017 and 2016, recoveries in commercial mortgage loans in the Virgin Islands exceeded charge-offs.
(2) For 2017, 2016 and 2014, recoveries in commercial and industrial loans in the Virgin Islands exceeded charge-offs.
(3) For 2017, recoveries in construction loans in the Virgin Islands exceeded charge-offs.
(4) For 2017, 2016 and 2014, recoveries in commercial mortgage loans in Florida exceeded charge-offs.
(5) For 2016, recoveries in commercial and industrial loans in Florida exceeded charge-offs.
(6) For 2018, 2017, 2016, 2015, and 2014, recoveries in construction loans in Florida exceeded charge-offs.
(7) For 2015 and 2014, recoveries in total loans in Florida exceeded charge-offs.

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.

Total credit losses (equal to net charge-offs plus losses on OREO operations) for 2018 amounted to $109.2 million, or an annualized 1.23% of average loans and repossessed assets, in contrast to credit losses of $129.0 million, or a loss rate of 1.53%, for the same period in 2017.

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

	Year Ended December 31, 2018	2017
(Dollars in thousands)		
OREO		
OREO balances, carrying value:		
Residential	$ 49,239	$ 54,381
Commercial	71,838	82,871
Construction	10,325	10,688
Total	$ 131,402	$ 147,940
OREO activity (number of properties):		
Beginning property inventory	708	626
Properties acquired	393	315
Properties disposed	(407)	(233)
Ending property inventory	694	708
Average holding period (in days)		
Residential	410	437
Commercial	1,347	1,026
Construction	1,377	1,403
	998	837
OREO operations (loss) gain:		
Market adjustments, impairments (net of insurance recoveries), and gains (losses) on sale:		
Residential	$ (5,233)	$ (2,794)
Commercial	(3,946)	(5,884)
Construction	(1,745)	(63)
	(10,924)	(8,741)
Other OREO operations expenses	(3,528)	(2,256)
Net Loss on OREO operations	$ (14,452)	$ (10,997)
CHARGE-OFFS		
Residential charge offs, net	$ (21,383)	$ (25,749)
Commercial charge offs, net	(23,871)	(52,922)
Construction charge offs, net	(7,962)	(2,875)
Consumer and finance leases charge-offs, net	(41,518)	(36,468)
Total charge-offs, net	(94,734)	(118,014)
TOTAL CREDIT LOSSES (1)	$ (109,186)	$ (129,011)
LOSS RATIO PER CATEGORY (2)**:**		
Residential	0.82%	0.86%
Commercial	0.75%	1.55%
Construction	7.57%	1.93%
Consumer	2.30%	2.11%

TOTAL CREDIT LOSS RATIO (3)	**1.23%**	**1.53%**

(1) Equal to net loss on OREO operations plus charge-offs, net.
(2) Calculated as net charge-offs plus market adjustments, impairments (net of insurance recoveries), and gains (losses) on sale of OREO divided by average loans and repossessed assets.
(3) Calculated as net charge-offs plus net loss on OREO operations divided by average loans and repossessed assets.

Operational Risk

The Corporation faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products. Coupled with external influences, such as market conditions, security risks, and legal risks, the potential for operational and reputational loss has increased. To mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation's business operations are functioning within the policies and limits established by management.

The Corporation classifies operational risk into two major categories: business-specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate-wide risks, such as information security, business recovery, and legal and compliance, the Corporation has specialized groups, such as the Legal Department, Information Security, Corporate Compliance, and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups.

Legal and Compliance Risk

Legal and compliance risk includes the risk of noncompliance with applicable legal and regulatory requirements, the risk of adverse legal judgments against the Corporation, and the risk that a counterparty's performance obligations will be unenforceable. The Corporation is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the years. The Corporation has established, and continues to enhance procedures based on legal and regulatory requirements that are designed to ensure compliance with all applicable statutory and regulatory requirements. The Corporation has a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of an enterprise-wide compliance risk assessment process. The Compliance division has officer roles in each major business area with direct reporting relationships to the Corporate Compliance Group.

Concentration Risk

The Corporation conducts its operations in a geographically concentrated area, as its main market is Puerto Rico. However, the Corporation has diversified its geographical risk, as evidenced by its operations in the Virgin Islands and in Florida. Of the total gross loan portfolio held for investment of $8.9 billion as of December 31, 2018, approximately 74% has credit risk concentration in Puerto Rico, 21% in the United States, and 5% in the Virgin Islands.

Update to the Puerto Rico Fiscal Situation

Economy indicators and projections

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, which has been in an economic recession since 2006 that has been exacerbated by the effects of Hurricanes Irma and Maria in 2017. The New Fiscal Plan approved by the PROMESA oversight board, as revised on October 23, 2018 (the "New Fiscal Plan"), projects a contraction in Puerto Rico's gross national product of 8.0% for fiscal year 2018, followed by projected growths of 7.9% and 5.5% for fiscal years 2019 and 2020, respectively. Such projected growth was based on an assumption that over $82 billion of disaster relief funding will enter the economy of Puerto Rico from federal and private sources. Of the total disaster relief funding of $82 billion, estimated amounts of approximately $66 billion are to be used for public assistance, $3 billion for individual assistance, $8 billion for private and business insurance pay outs, and $5 billion is related to other federal funding. On July 30, 2018, HUD approved a $1.5 billion disaster recovery plan submitted by the Puerto Rico government that primarily focuses on the restoration of damaged and destroyed homes, businesses and infrastructure. The disaster recovery action plan includes the following activities: (i) housing ($1 billion) – for rebuilding and repairs of damaged properties, rental assistance, and appliances; (ii) economic revitalization ($145 million) – for eligible businesses to help-revitalize the post-disaster economy, including through grants; and (iii) infrastructure ($100 million) – for repairs of the damaged infrastructure in Puerto Rico. In February 2019, the Puerto Rico governor announced that HUD authorized the disbursement and use of funds approved through the aforementioned disaster recovery plan.

The Puerto Rico Economic Activity Index (the "EDB-EAI") in November 2018 was 120.3, close to pre-hurricane levels of 122.1 in August 2017, and a 21.5% growth compared to post-hurricane levels of 99.0 in November 2017, mainly related to interruption of the electric energy system in 2017 due to Hurricanes Irma and Maria. The EDB-EAI is a coincident index of economic activity for Puerto Rico made up of four indicators (non-farm payroll employment, electric power generation, cement sales and gasoline consumption). The cement sales for November 2018 totaled 1.2 million of 94-pound bags, an increase of 6.3% over the prior month, and an annual increase of 64.3%. Estimated gasoline consumption in November 2018 was 78.1 million gallons, a 2.8% decrease when compared with October 2018, and a decrease of 6.7% compared to the same period in 2017. Electric power generation for November 2018 totaled 1,532.5 million kilowatt-hours, an increase of 3.3% over the prior month, and an annual increase of 94.7% compared with the same period in 2017. The revised version of the New Fiscal Plan projects that the hurricanes will create a spike in inflation of 1.6% in fiscal year 2018, with subsequent average increases of about 1.49% over the next six years, until fiscal year 2023. The seasonally adjusted unemployment rate in Puerto Rico was 8.3% in December 2018, compared to 11.0% in December 2017. The Puerto Rico labor force participation rate was 40.8% as of December 2018. The average of the labor force participation rate in Puerto Rico was 45.05% from 1990 until 2017, reaching an all-time high of 49.80% in February of 2007 and a record low of 38.6% in October of 2017. Based on information published by the Puerto Rico government, the labor force estimate was 1.1 million people as of December 2018, a reduction of 1.4% when compared with December 2017. The New Fiscal Plan reflects a 5.5% decline in population by fiscal year 2023.

Based on information published by the Puerto Rico Treasury, the net revenues of the Puerto Rico government's General Fund in November 2018 totaled $556.9 million, which was $16.8 million less than in November 2017, and $25.5 million over projections of the New Fiscal Plan. The net revenue to the General Fund for the first five months of the fiscal year ending June 30, 2019 totaled $3,540.2 million, an increase of $611.8 million, compared with the same period of the previous fiscal year.

GDB Liquidation Plan

On July 14, 2017, the PROMESA oversight board authorized the GDB to pursue the restructuring of its debts under Title VI of PROMESA and conditionally certified the GDB's Restructuring Support Agreement ("RSA") under the relevant provisions of Title VI. The PROMESA oversight board's decision was in response to a request from Puerto Rico's Fiscal Agency and Financial Advisory Authority, dated June 30, 2017, in which the agency noted that the proposed restructuring, along with certain related settlements contemplated by the RSA, will result in an efficient wind down of the GDB's operations and a comprehensive financial restructuring of the GDB's obligations. The RSA provides for the organized and consensual restructuring of a substantial portion of the GDB's liabilities, including the GDB public bonds, deposit claims by municipalities and certain non-public entities, and claims under certain GDB-issued letters of credit and guarantees. In exchange for releasing the GDB from liability relating to these claims, the claim-holders will receive new bonds to be issued by a new entity.

On April 20, 2018, the PROMESA oversight board approved the new GDB fiscal plan. The new GDB fiscal plan authorizes the recently amended terms of RSA. It also paves the way for the GDB's operational wind-down, provides for a simplified transaction structure, and ensures equal treatment of creditors. It also offers municipalities offset rights against their deposit claims.

New Fiscal Plan

The New Fiscal Plan approved by the PROMESA oversight board, uses a six-year horizon and projects a 5.5% decline in population by fiscal year 2023. In addition, the revised New Fiscal Plan established an annual emergency reserve of $130 million for 10 years. As mentioned above, it also assumes $82 billion in disaster relief funding and projects that a $30 billion surplus will be generated through fiscal year 2033. The New Fiscal Plan includes a series of structural reforms in areas, such as: (i) human capital and labor; (ii) ease of doing business; (iii) power sector reform; and (iv) infrastructure reform. The New Fiscal Plan also proposes fiscal measures projected to drive $12.4 billion in increased revenues and reduced expenditures through fiscal year 2023 and projects that structural reforms will drive a cumulative 1.21% increase in growth by fiscal year 2058.

Commonwealth of Puerto Rico Budget

On May 10, 2018, the Puerto Rico governor proposed the Commonwealth of Puerto Rico's budget for fiscal year 2018-2019. The proposed consolidated budget amounts to $25.3 billion and comes from the following sources:

- $8.7 billion from General Fund
- $8.1 billion from Federal Funds
- $7.5 billion from Revenue Funds
- $0.4 billion from Special State Funds
- $0.6 billion from Other Governmental Funds

The recommended General Fund budget amounted to $8.7 billion, a net decrease of $0.8 billion when compared with the budget approved for the fiscal year 2017-2018. On the other hand, the Federal Funds budgeted amount included in the proposed budget shows an increase of $1.8 billion or 28% more compared with the budget for fiscal year 2017-2018. However, the PROMESA oversight board concluded that the proposed Commonwealth of Puerto Rico budget for fiscal year 2018-2019 does not comply with the Fiscal Plan approved on April 19, 2018. On June 29, 2018, the PROMESA oversight board stated that, because of the Puerto Rico government's failure to enact labor reform, including the repeal of the law on unjustified work dismissals (Law 80), it had certified a new revised version of the New Fiscal Plan that reflects, among other changes, a reduction of the projected 30-year surplus of the central government to $14.4 billion from the previous projection between $39 billion to $40 billion, the elimination of Christmas bonuses for public employees, and lower funding for infrastructure and municipalities.

On June 30, 2018, the PROMESA oversight board certified a revised budget for fiscal year 2019 that outlines expenditures of $8,757 million for the General Fund and $20,663 million for the consolidated budget.

On July 5, 2018, the Puerto Rico government filed a lawsuit seeking declaratory judgment that clarifies the PROMESA oversight board's power over the Commonwealth's budget.

On August 7, 2018, the U.S. District Judge Laura Taylor Swain ruled that the PROMESA oversight board has the power to enforce fiscal discipline through the budgetary process, but lacks authority to demand changes in laws.

Puerto Rico Tax Reform of 2018 – Law Act 257

On December 10, 2018, the Governor of Puerto Rico signed into Law Act 257, which amends numerous provisions of the Puerto Rico Internal Revenue Code of 2011, including reducing the corporate and individual income tax rates, introducing a new earned income credit, limiting certain deductions, subjecting the gain on the sale of a Puerto Rico partnership interest to Puerto Rico income tax, changing certain sourcing rules, and amending the information reporting requirements. Act 257 also amended certain sales and use tax provisions. Please refer to Note 26 – Income Taxes, of the audited consolidated financial statements for the year ended December 31, 2018 included in Item 8 of this Form 10-K for additional information, including the effect of the remeasurement of the Corporation's deferred tax assets due to the reduction in the maximum statutory tax rate in Puerto Rico from 39% to 37.5%. The PROMESA oversight board expressed concerns regarding certain provisions of Act 257. In particular, the PROMESA oversight board indicated that it has not received enough evidence from the Puerto Rico government to conclude that Act 257 will not negatively impact the Puerto Rico government's fiscal Plan. It has not yet been determined whether Act 257 will be further amended to accommodate any mandate from the PROMESA oversight board. The PROMESA oversight board issued a letter to the Governor of Puerto Rico on December 27, 2018 stating that Act 257 is not in compliance with PROMESA with respect to Articles 132 through 163, regarding the video lottery terminals (VLTs) that operate outside casinos in Puerto Rico. However, the letter provided that the PROMESA oversight board accepted Articles 1 through 131 and 164-165, which do not deal with VLTs operated outside casinos in Puerto Rico.

The Third Amended Title III Plan of Adjustment (the "COFINA plan")

On February 4, 2019, the U.S. District Judge Laura Taylor Swain, approved the COFINA plan, a restructuring agreement for bondholders of debt issued by the Puerto Rico Sales Tax Financing Corporation ("COFINA," by its Spanish acronym). The COFINA plan restructures $18.0 billion of COFINA debt, which represents 24% of Puerto Rico's funded debt. In addition, the COFINA plan reduced the annual cash flow to COFINA from a maximum of $1.8 billion to $992 million and provides to the Government of Puerto Rico an average annual savings of $425 million for the next 40 years.

Recent Developments

On February 15, 2019, the U.S. Court of Appeals for the First Circuit held that members of the PROMESA oversight board created by PROMESA are "Officers of the Unites States" subject to the U.S. Constitution's Appointments Clause and directed the district court to enter a declaratory judgement to the effect that PROMESA's protocol for the appointment of Board Members is unconstitutional.

This matter arose from the restructuring of Puerto Rico's public debt under PROMESA. In May 2017, the PROMESA oversight board exercised its authority under Title III of PROMESA to initiate debt adjustment proceedings on behalf of the Puerto Rico government. Appellants sought to dismiss the Title III proceedings, arguing that the PROMESA oversight board lacked authority to initiate them because the PROMESA oversight board members were illegally appointed in contravention of the Appointments Clause. The district court rejected Appellants' motions to dismiss. The First Circuit reversed in part, (1) the Territorial Clause does not displace the Appointments Clause in an unincorporated territory such as Puerto Rico; (2) Board Members are "Principal" "Officers of the United States" subject to the Appointments Clause; and (3) therefore, the process PROMESA provides for the appointment of Board Members is unconstitutional. The U.S. Court of Appeals for the First Circuit set a 90-day period to allow President Donald Trump and the U.S. Senate to constitutionally validate the appointments or reconstitute the PROMESA oversight board.

On February 22, 2019, the U.S. Court of Appeals for the First Circuit affirmed the district court's dismissal of Plaintiffs' complaint against the PROMESA oversight board and its members and executive director alleging that the PROMESA oversight board had exceeded its power under PROMESA during the 2019 fiscal plan and the Commonwealth of Puerto Rico's budget development and certification processes, holding that the complaint was properly dismissed.

Exposure to the Puerto Rico Government

As of December 31, 2018, the Corporation had $214.6 million of direct exposure to the Puerto Rico government, its municipalities and public corporations, compared to $214.5 million as of December 31, 2017. As of December 31, 2018, approximately $191.9 million of the exposure consisted of loans and obligations of municipalities in Puerto Rico that are supported by assigned property tax revenues and for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment, compared to $184.6 million as of December 31, 2017. Approximately 75% of the Corporation's municipality exposure consisted primarily of senior priority obligations concentrated in three of the largest municipalities in Puerto Rico. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. The PROMESA oversight board has not designated any of the Commonwealth's 78 municipalities as covered entities under PROMESA. However, while the revised fiscal plan certified by the PROMESA oversight board did not contemplate a restructuring of the debt of Puerto Rico's municipalities, the plan did call for the gradual elimination of budgetary subsidies provided to municipalities. Furthermore, municipalities are also likely to be affected by the negative economic and other effects resulting from expense, revenue or cash management measures taken to address the Puerto Rico government's fiscal and liquidity shortfalls, as well as measures included in fiscal plans of other government entities. In addition to municipalities, the total direct exposure also included a $14.5 million loan to an affiliate of PREPA and obligations of the Puerto Rico government, specifically bonds of the Puerto Rico Housing Finance Authority, at an amortized cost of $8.2 million as part of its available-for-sale investment securities portfolio (fair value of $7.0 million as of December 31, 2018).

The following table details the Corporation's total direct exposure to the Puerto Rico government according to their maturities:

	As of December 31, 2018		
	Investment Portfolio (Amortized cost)	**Loans**	**Total Exposure**
(In thousands)			
Puerto Rico Housing Finance Authority:			
After 5 to 10 years	$ 4,000	$ -	$ 4,000
After 10 years	4,185	-	4,185
Total Puerto Rico Housing Finance Authority	8,185	-	8,185
Public Corporations:			
Affiliate of the Puerto Rico Electric Power Authority:			
After 1 to 5 years	-	14,489	14,489
Total Public Corporations	-	14,489	14,489
Municipalities:			
After 1 to 5 years	6,100	32,156	38,256
After 5 to 10 years	53,016	15,000	68,016
After 10 years	85,699	-	85,699
Total Municipalities	144,815	47,156	191,971
Total Direct Government Exposure	$ 153,000	$ 61,645	$ 214,645

In addition, as of December 31, 2018, the Corporation had $112.1 million in exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to $75 million of the principal under the mortgage loan insurance program. According to the most recently-released audited financial statements of the Puerto Rico Housing Finance Authority, as of June 30, 2016, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans in an aggregate of approximately $576 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loan insurance fund. As of June 30, 2016, the most recent date as to which information is available, the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately $77.4 million.

As of December 31, 2018, the Corporation had $677.3 million of public sector deposits in Puerto Rico, compared to $490.3 million as of December 31, 2017. Approximately 34% is from municipalities and municipal agencies in Puerto Rico and 66% is from public corporations and the central government and agencies in Puerto Rico.

Exposure to USVI government

The Corporation has operations in the USVI and has credit exposure to USVI government entities.

The USVI is experiencing a number of fiscal and economic challenges, exacerbated by the impact of Hurricane Irma in the third quarter of 2017, that could adversely affect the ability of its public corporations and instrumentalities to service their outstanding debt obligations. PROMESA does not apply to the USVI and, as such, there is currently no federal legislation permitting the restructuring of the debts of the USVI and its public corporations and instrumentalities.

To the extent that the fiscal condition of the USVI government continues to deteriorate, the U.S. Congress or the government of the USVI may enact legislation allowing for the restructuring of the financial obligations of the USVI government entities or imposing a stay on creditor remedies, including by making PROMESA applicable to the USVI.

As of December 31, 2018, the Corporation had $55.8 million in loans to USVI government instrumentalities and public corporations, compared to $70.4 million as of December 31, 2017. Of the amount outstanding as of December 31, 2018, public corporations of the USVI owed approximately $32.6 million and an independent instrumentality of the USVI government owed approximately $23.2 million. As of December 31, 2018, all loans were currently performing and up to date on principal and interest payments.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in conformity with GAAP, which requires the measurement of the financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a greater impact on a financial institution’s performance than the effects of general levels of inflation. Interest rate movements are not necessarily correlated with changes in the prices of goods and services.

BASIS OF PRESENTATION

The Corporation has included in this Form 10-K the following financial measures that are not recognized under GAAP, which are referred to as non-GAAP financial measures:

1. Net interest income, interest rate spread, and net interest margin are reported excluding the changes in the fair value of derivative instruments and on a tax-equivalent basis in order to provide to investors additional information about the Corporation's net interest income that management uses and believes should facilitate comparability and analysis. The changes in the fair value of derivative instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively. The tax-equivalent adjustment to net interest income recognizes the income tax savings when comparing taxable and tax-exempt assets and assumes a marginal income tax rate. Income from tax-exempt earning assets is increased by an amount equivalent to the taxes that would have been paid if this income had been taxable at statutory rates. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread, and net interest margin on a fully tax-equivalent basis. This adjustment puts all earning assets, most notably tax-exempt securities and tax-exempt loans, on a common basis that facilitates comparison of results to the results of peers. See "Results of Operations - Net Interest Income" above for the table that reconciles the non-GAAP financial measure "net interest income excluding fair value changes and on a tax-equivalent basis" with net interest income calculated and presented in accordance with GAAP. The table also reconciles the non-GAAP financial measures "net interest spread and margin excluding fair value changes and on a tax-equivalent basis" with net interest spread and margin calculated and presented in accordance with GAAP.

2. The tangible common equity ratio and tangible book value per common share are non-GAAP financial measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible and the insurance customer relationship intangible. Tangible assets are total assets less goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible and the insurance customer relationship intangible. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase method of accounting for mergers and acquisitions. Accordingly, the Corporation believes that disclosure of these financial measures is useful to investors. Neither tangible common equity nor tangible assets, or the related measures, should be considered in isolation or as a substitute for stockholders' equity, total assets, or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Corporation calculates tangible common equity, tangible assets, and any other related

measures may differ from that of other companies reporting measures with similar names. See “Risk Management – Capital” above for a reconciliation of the Corporation’s tangible common equity and tangible assets.

3. Adjusted provision for loan and lease losses and the ratio of adjusted provision for loan and lease losses to net charge-offs are non-GAAP financial measures that exclude the effects related to the net loan loss reserve release of $16.9 million recorded in the year ended December 31, 2018 and a $71.3 million charge to the provision for loan and lease losses in the year ended December 31, 2017 in connection with estimates of the qualitative reserves associated with the effects of Hurricanes Irma and Maria. Management believes that this information helps investors understand the adjusted measures without regard to items that are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts on reported results and facilitates comparisons with prior periods.

4. Adjusted net income that reflects the following exclusions:

- Tax benefit of $63.2 million resulting from the partial reversal of the Corporation’s deferred tax asset valuation allowance in 2018.

- Exclusion of the one-time charge to tax expense of $9.9 million related to the enactment of the Puerto Rico Tax Reform of 2018.

- Net loan loss reserve release of $16.9 million in 2018 and a charge to the provision for loan and lease losses of $71.3 million in 2017 associated with the estimates of the hurricane-related qualitative reserves.

- Gain of $0.5 million from hurricane-related insurance proceeds recorded in 2018.

- Exclusion of hurricane-related expenses of $2.8 million and $2.5 million in 2018 and 2017, respectively.

- Exclusion of $1.8 million of expected insurance recoveries from compensation and rental costs that the Corporation incurred when Hurricanes Irma and Maria precluded employees from working in 2017.

- Loss of $34 thousand on sales of U.S. agency MBS and debt securities in 2018 and gain of $6.1 million on sales of U.S. agency MBS in 2016.

- OTTI on debt securities of $50 thousand, $12.2 million, and $6.7 million in 2018, 2017, and 2016, respectively.

- Recovery of $0.4 million of previously recorded OTTI charges on non-performing bonds of the GDB and the Puerto Rico Public Buildings Authority sold in 2017.

- Gains of $2.3 million, $1.4 million, and $4.2 million in 2018, 2017, and 2016, respectively, related to the repurchase and cancellation of trust-preferred securities.

- Gain of $1.5 million from the recovery of a residual CMO previously written off recorded in 2016.

- Brokerage and insurance commissions (net of incentives costs) of $1.7 million from the sale of large fixed annuities contracts in 2016.

- Inclusion of a $2.7 million adjustment recorded in 2016 to reduce the credit card rewards liability due to unusually large customer forfeitures related to the expiration of reward points earned by customers up to September 2013 (the conversion date of the credit card portfolio acquired from FIA in May 2012). Most of these points had been accrued at the acquisition date and ultimately experienced a redemption pattern materially different from those points accrued after conversion.

- Exclusion of costs of $0.4 million and $0.6 million associated with secondary offerings of the Corporation’s common stock by certain of its stockholders completed in 2017 and 2016, respectively.

- Exclusion of costs above what the Corporation believes are the normal or recurring level for severance payments of $0.3 million related to permanent job discontinuance in 2016.

- The tax-related effects of all the pre-tax items mentioned in the above bullets as follows:

– Tax expense of $6.6 million in 2018 related to reserve releases associated with the hurricane-related qualitative reserve, and tax benefit of $27.8 million related to the charge to the provision in 2017 associated with the effects of Hurricanes Irma and Maria (calculated based on the statutory tax rate of 39%).

– Tax expense of $0.2 million associated with the gain from hurricane-related insurance proceeds recorded in 2018 (calculated based on the statutory tax rate of 39%).

– Tax benefit of $1.1 million and $1.0 million in 2018 and 2017, respectively, related to hurricane-related expenses (calculated based on the statutory tax rate of 39%).

– Tax expense of $0.3 million related to the gain from the recovery of a residual CMO previously written off recorded in 2016 (calculated based on the applicable capital gain tax rate of 20%)

– Tax expense of $0.7 million related to brokerage and insurance commissions from the sale of large fixed annuities contracts, net of incentive costs, recorded in 2016 (calculated based on the statutory tax rate of 39%).

– Tax expense of $1.1 million related to the adjustment to reduce the credit card rewards liability due to unusually large customer forfeitures recorded in 2016 (calculated based on the statutory tax rate of 39%).

– Tax expense of $0.2 million related to the taxable portion of the gain on sale of U.S. agency MBS recorded in 2016 (calculated based on the applicable capital gain tax rate of 20%).

– Tax benefit of $0.1 million related to the severance expense recorded in 2016 (calculated based on the statutory tax rate of 39%).

– No tax benefit was recorded for the loss on sales of U.S. agency MBS in 2018 and for OTTI charges in 2018, 2017, and 2016. Those charges were recorded at the international banking entity subsidiary level.

– No tax expense was recorded in 2017 for the partial recovery of previously recorded OTTI charges on tax-exempt bonds sold.

– The gains realized on the repurchase and cancellation of trust-preferred securities in 2018, 2017, and 2016 and costs incurred associated with secondary offerings completed in 2017 and 2016, recorded at the holding company level, had no effect on the income tax expense in 2018, 2017, and 2016.

Management believes that adjustments to net income of items that are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts facilitates comparisons with prior periods and provides an alternate presentation of the Corporation’s performance.

The Corporation uses these non-GAAP financial measures, and believes that these non-GAAP financial measures enhance the ability of analysts and investors to analyze trends in the Corporation’s business and understand the performance of the Corporation. In addition, the Corporation may utilize these non-GAAP financial measures as a guide in its budgeting and long-term planning process. Any analysis of these non-GAAP financial measures should be used only in conjunction with results presented in accordance with GAAP.

See "Executive Overview of Results of Operations" above for the reconciliation of the non-GAAP financial measure "adjusted net income" to the GAAP financial measure net income. The following tables reconcile the non-GAAP financial measures "adjusted provision for loan and lease losses," and "adjusted provision for loan and lease losses to net charge-offs," to the GAAP financial measures for the years ended December 31, 2018 and 2017:

2018	**As reported (GAAP)**	**Hurricane-related Qualitative Reserve Release**	**Adjusted (Non-GAAP)**
(Dollars in thousands)			
Provision for loan and lease losses	**$ 59,253**	**$ 16,943**	**$ 76,196**
Residential mortgage Loans	13,202	374	13,576
Commercial mortgage Loans	23,074	1,925	24,999
Commercial and industrial Loans	(8,440)	5,511	(2,929)
Construction Loans	7,032	729	7,761
Consumer Loans	24,385	8,404	32,789

2017	**As reported (GAAP)**	**Hurricane-related Provision for Loan and Lease Losses**	**Adjusted (Non-GAAP)**
(Dollars in thousands)			
Provision for loan and lease losses	**$ 144,254**	**$ (71,304)**	**$ 72,950**
Residential mortgage Loans	50,744	(14,581)	36,163
Commercial mortgage Loans	30,054	(12,105)	17,949
Commercial and industrial Loans	1,018	(15,947)	(14,929)
Construction Loans	4,835	(3,660)	1,175
Consumer Loans	57,603	(25,011)	32,592

The following table reconciles the provision for loan and lease losses to net charge-offs to the Non-GAAP financial measure "adjusted provision for loan and lease losses to adjusted net-charge-offs" for 2018 and 2017:

(Dollars in thousands)	(GAAP to Non GAAP reconciliation) Year Ended December 31, 2018		December 31, 2017	
	Provision for Loan and Lease Losses	Net Charge-Offs	Provision for Loan and Lease Losses	Net Charge-Offs
Provision for loan and lease losses and net charge-offs (GAAP)	$ 59,253	$ 94,734	$ 144,254	$ 118,014
Less Special Items:				
Hurricane-related reserve release (provision)	16,943	-	(71,304)	-
Provision for loan and lease losses and net charge-offs, excluding special items (Non-GAAP)	$ 76,196	$ 94,734	$ 72,950	$ 118,014
Provision for loan and lease losses to net charge-offs (GAAP)	62.55%		122.23%	
Provision for loan and lease losses to net charge-offs, excluding special items (Non-GAAP)	80.43%		61.81%	

Selected Quarterly Financial Data

Financial data showing results of the 2018 and 2017 quarters is presented below. In the opinion of management, all adjustments necessary for a fair presentation have been included. These results are unaudited.

	2018			
	March 31	June 30	September 30	December 31
	(In thousands, except for per share results)			
Interest income	$ 149,418	$ 155,633	$ 157,492	$ 162,424
Net interest income	124,693	130,471	132,521	137,698
Provision for loan and lease losses	20,544	19,536	11,524	7,649
Net income	33,148	31,032	36,323	101,105
Net income attributable to common stockholders - basic	32,479	30,363	35,654	100,436
Net income attributable to common stockholders - diluted	32,479	30,363	35,654	100,436
Earnings per common share - basic	$ 0.15	$ 0.14	$ 0.16	$ 0.46
Earnings per common share - diluted	$ 0.15			