



GOVERNMENT OF PUERTO RICO

Puerto Rico Fiscal Agency and Financial Advisory Authority

Municipal Secondary Market Disclosure Information Cover Sheet
Municipal Securities Rulemaking Board (MSRB)
Electronic Municipal Market Access System (EMMA)

THIS FILING RELATES TO A SINGLE BOND ISSUE:

Name of bond issue exactly as it appears on the cover of the Official Statement:

Three horizontal lines for bond issue name

Nine-digit CUSIP numbers if available, to which the information relates:

Two horizontal lines for CUSIP numbers

THIS FILING RELATES TO ALL OR SEVERAL SECURITIES ISSUED BY THE ISSUER, OR ALL OR SEVERAL SECURITIES OF A SPECIFIC CREDITOR:

Issuer's Name: Puerto Rico Housing Finance Authority

Other Obligated Person's Name (if any):

CUSIP numbers: Mortgage-Backed Certificates, 2006 Series A (74526LBC6, 74526LBD4, 74526LBE2, 74526LBF9, 74526LBG7, 74526LBH5, 74526LBJ1, 74526LBK8, 74526LBL6, 74526LBM4, 74526LBN2, 74526LBP7, 74526LBQ5, 74526LBR3, 74526LBS1, 74526LBT9, 74526LBU6, 74526LBV4); and Portfolio XI (74527ACG9, 74527ACH7, 74527ACJ3, 74527ACK0, 74527ACL8, 74527ACM6, 74527ACN4, 74527ACP9).

TYPE OF INFORMATION PROVIDED:

- A. Annual Financial Information and Operating Data pursuant to Rule 15c2-12
B. Audited Financial Statements or CAFR pursuant to Rule 15c2-12
C. Notice of Failure to Provide Annual Financial Information as Required

I represent that I am authorized by the issuer, obligor or its agent to distribute this information publicly.

/s/ Sebastián M. Torres Rodríguez
Sebastián M. Torres Rodríguez
Puerto Rico Fiscal Agency and Financial Advisory Authority,
as Fiscal Agent for the Commonwealth

Dated: May 1, 2017



Puerto Rico Housing Finance Authority
*(A Component Unit of the Government Development
Bank for Puerto Rico)*

*Basic Financial Statements for the Year Ended
June 30, 2016 and Independent Auditors' Report*

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Basic Financial Statements For the Year Ended June 30, 2016 and Independent Auditors' Report

TABLE OF CONTENTS

	<u>Pages</u>
Independent Auditors' Report	1 – 4
Management's Discussion and Analysis (Unaudited)	5 – 15
Basic Financial Statement	
Government Wide Financial Statements:	
Statement of Net Position	16
Statement of Activities	17
Fund Financial Statements:	
Balance Sheet – Governmental Funds	18
Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Position	19
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds	20
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds to the Statement of Activities	21
Balance Sheet – Proprietary Fund – Operating and Administrative Fund	22 – 23
Statement of Revenues, Expenses and Change in Net Position – Proprietary Fund – Operating and Administrative Fund	24
Statement of Cash Flows – Proprietary Fund – Operating and Administrative Fund	25 – 26
Notes to Basic Financial Statements	27 – 66

INDEPENDENT AUDITORS' REPORT

The Board of Directors of
Puerto Rico Housing Finance Authority
San Juan, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities and each major fund of the *Puerto Rico Housing Finance Authority* (the Authority) (a component unit of the Government Development Bank for Puerto Rico) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Qualified Opinion on Business-type Activities, Proprietary Fund and Note Disclosure Regarding Pensions

As discussed in note 14 to basic financial statements, the Authority has not implemented the requirements of Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27 (Statement No. 68)*. Accordingly, the Authority has not been able to determine and account for its proportionate share of net pension liability, deferred inflow of resources and deferred outflow of resources related to pension costs and, the Authority has not recognized the effect of current period changes in net pension obligation, deferred outflow of resources and deferred inflow of resources as these relate to pension costs for the year ended June 30, 2016.

Accounting principles generally accepted in the United States of America require that net pension liability, deferred outflow of resources, deferred inflow of resources, as applicable, be recognized in accordance with the parameters established by Statement No. 68, as well as the effect of current period changes of the aforementioned amounts that must be recognized in pension expense during the current period. Recognition of these amounts would increase liabilities, increase deferred outflow of resources, increase deferred inflow of resources, increase the deficit, and change the pension expenses of the governmental activities. The amounts by which this departure would affect liabilities, deferred outflow of resources, deferred inflow of resources, deficit, and expenses of the governmental activities has not been determined.

The accompanying notes to the basic financial statements do not disclose the pension cost information required by Statement No. 68. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

Qualified Opinion

In our opinion, except for the possible effects of the matter described above in the Basis for Qualified Opinion on Business-type Activities, Proprietary Fund and Note Disclosure Regarding Pensions paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Business-type activities, and Proprietary Fund of the ***Puerto Rico Housing Finance Authority*** as of June 30, 2016 and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Unmodified Opinions

In our opinion the financial statements referred to above present fairly, in all material respects, the respective financial position of the Governmental Activities and each major governmental fund of the ***Puerto Rico Housing Finance Authority*** as of June 30, 2016, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Custodial Credit Risk Loss

As discussed in note 3, the Authority recognized a custodial credit risk loss of \$116,506,240 which represents the estimated amount of deposits at GDB as of June 30, 2017, that management has a significant uncertainty as to its recovery, as a result of the financial condition and lack of liquidity of GDB.

The Authority's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in as discussed in notes 3 and 12 to basic financial statements, the Authority has significant balances and transactions with the Commonwealth and GDB. Additionally, GDB has provided significant financial support to the Authority in terms of notes payable and lines of credit. As of June 30, 2016, GDB has significant balances of loans receivable from the Commonwealth, its agencies and instrumentalities. These loans are expected to be collected from appropriations from, proceeds from bond issuances of, or revenues generated by the Commonwealth and/or its agencies and instrumentalities. Accordingly, the collectability of these loans may be affected by budgetary constraints, the fiscal situation, the credit rating of the Commonwealth, its agencies and instrumentalities, and their ability to generate sufficient funds from taxes, charges and/or bond issuances. Continuance of and/or significant negative changes in these factors may have an adverse impact on GDB's financial condition, liquidity, funding sources, and results of operations, which could also result in an adverse impact on the Authority's financial condition, liquidity, funding sources, and results of operations.

The management of the Authority has expressed that their ability to effectively manage its liquidity resources given the liquidity situation of the GDB imposes a significant uncertainty about its ability to comply with the terms of its debt as it becomes due. Accordingly, we believe there is substantial doubt about the ability of the Authority to continue as a going concern. Besides the matters disclosed in note 3, the Authority is not aware of any alternate sources of funds to continue operating as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information Omitted

The Authority has omitted the *Schedule of the Authority's Proportionate Share of the Net Pension Liability*, and the *Schedule of Authority's Contributions to the Employees' Pension Plan*, information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion on pages 5 through 14 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

HLB Parissi PSC

San Juan, Puerto Rico
April 27, 2017

Stamp No. E247195 was affixed
to the original of this report
License No. 88 Exp. December 1, 2017



Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

This management's discussion and analysis (MD&A) provides a narrative overview and analysis of the financial activities of the ***Puerto Rico Housing Finance Authority*** (the Authority) for the fiscal year ended June 30, 2016. The MD&A is intended to serve as an introduction to the Authority's basic financial statements, which have the following components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to basic financial statements. The MD&A is designed to (a) assist the reader in focusing on significant financial matters, (b) provide an overview of the Authority's financial activities, and (c) highlight individual fund matters. The following presentation is by necessity highly summarized, and in order to gain a thorough understanding of the Authority's financial condition, the following financial statements, notes and required supplementary information should be reviewed in their entirety.

Financial Highlights

- Net position of the Authority decreased \$142.2 million, from a beginning of the year amount of \$413.9 million to \$271.7 million as of June 30, 2016.
- As a result of the continuing deterioration of the economic and fiscal situation of the Commonwealth of Puerto Rico and GDB, the Authority recorded a custodial credit risk loss on deposits amounting to \$116,506,240.
- On February 1, 2016 and March 3, 2016, the Authority sold certain single and multi-family mortgage loans to a financial institution and a private investor. The mortgage portfolios unpaid balance at the time of sale was approximately \$109.1 million, and the net proceeds amounted to approximately, \$89.3 million. The mortgage portfolios were sold to partially repay My New Home Program line of credit in order to provide liquidity to GDB.
- Operating income of the Operating and Administrative fund was \$1 million for the year ended June 30, 2016 compared to \$4.5 million in June 30, 2015. There were net interfund transfers in the amount of \$96.9 million during the year ended June 30, 2016. Total operating revenues of the proprietary fund decreased to \$39.5 million from \$41.1 million in 2015. Total operating expenses of the proprietary fund increased to \$38.5 million in 2016 from \$36.6 million in 2015.
- During fiscal year 2016, \$143.2 million and \$28.4 million were granted in subsidies through the Housing Urban Development Program (HUD) and the HOME Program, respectively.
- \$10.8 million were granted in subsidies through the Affordable Housing Mortgage Subsidy Programs.
- On July 31, 2014, the Governor of the Commonwealth of Puerto Rico signed the Home Investment Partnerships Program (HOME) Voluntary Repayment Settlement Agreement (the Agreement) with HUD. The Agreement establishes the reimbursement to the HOME program of \$14.2 million, from nonfederal funds, for disallowed expenditures in connection with HUD-funded projects, as defined and described in the Agreement, in two installments of \$10 million and \$4.2 million due on

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

October 1, 2014 and October 1, 2015, respectively. The payments were made on such dates in accordance with the Agreement.

Using this Report

This report consists of a series of financial statements and supplementary information. The Statement of Net Position and the Statement of Activities as well as the Proprietary Fund financial statements provide information about the activities of the Authority as a whole and present a longer-term view of the Authority's finances. Governmental funds financial statements show how services were financed in the short-term, as well as how much may remain for future spending. Fund financial statements also report the Authority's operations in more detail than the government-wide statements by providing information about the Authority's major funds.

The Statement of Net Position and the Statement of Activities

One of the most important questions asked about the Authority's finances is: "Is the Authority, as a whole, better off or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Activities report information about the Authority as a whole and about its activities in a way that helps answer this question. These statements include all assets, deferred outflows of resources, liabilities and deferred inflow of resources using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account, regardless of when cash was received or paid.

These two statements report the Authority's net position and changes in it. One can think of the Authority's net position – the difference between assets and deferred outflows of resources, and liabilities – as one way to measure the Authority's financial health, or financial position. Over time, increases or decreases in net position is one indicator of whether its financial health is improving or deteriorating. One may need to consider other non-financial factors, such as changes in the Authority's operating nature, the low income housing subsidy and mortgage environments, new laws and regulations, as well as the financial health of the Government Development Bank for Puerto Rico (GDB), which is the Authority's primary government.

In the Statement of Net Position and the Statement of Activities, operations of the Authority are divided into two kinds of activities:

- *Governmental Activities* – Most of the Authority's basic services are reported here, such as low income housing assistance programs financed through federal grants.
- *Business-type Activities* – The Authority charges fees to its customers help it cover all or part of the cost of certain services it provides. Main activities included herein include programs for financing purchase of residential units by low and moderate-income families and loan insurance programs.

This space is left intentionally blank.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

Reporting Major Funds

Fund Financial Statements

Financial statements prepared at the fund level provide additional details about the Authority's financial position and activities. By definition, funds are accounting entities with a self-balancing set of accounts created for the purpose of carrying on specific activities or achieving specific goals. Information presented in the governmental fund financial statements differs from the information presented in the government-wide statements because the perspective and basis of accounting used to prepare the governmental fund financial statements are different than the perspective and basis of accounting used to prepare the government-wide statements. The Authority's governmental and proprietary fund types use different perspectives and accounting bases. The funds presented in the fund financial statements are categorized as major funds as required by accounting principles generally accepted in the United States of America (GAAP).

The Authority uses two fund types for operations – governmental and proprietary.

- *Governmental Funds* – Most of the Authority's basic services and expenditures are reported in governmental funds, which focus on how money flows into and out of those funds and the balances remaining at year-end that are available for spending. Governmental fund financial statements are prepared using the current financial resources measurement focus and the modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash. Assets and liabilities that do not impact current financial resources, such as capital assets and long-term liabilities, are not recognized in the governmental funds statements. The governmental funds statements provide a detailed short-term view of the Authority's low income housing programs financed with federal financial assistance programs. Governmental funds information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the Authority's programs. The reconciliations between governmental activities (reported in the Statement of Net Position and the Statement of Activities) and governmental funds are presented following the fund financial statements.
- *Proprietary Funds* – These funds are utilized when the Authority charges customers to recover its costs of providing services. Proprietary funds report on business-type activities, which include one enterprise fund. The Authority's enterprise fund is the same as the business-type activities reported in the government-wide statements. Proprietary Funds statements are prepared using the economic resources measurement focus and the accrual basis of accounting. In addition to a Balance Sheet and a Statement of Revenues, Expenses and Changes in Net Position, Proprietary Funds are also required to report a Statement of Cash Flows.

Notes to Basic Financial Statements – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide financial statements and the fund financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

Overall Financial Position and Results of Operations

We provide the readers of these basic financial statements with the following summarized discussion and analysis of the relevant facts that affected the government-wide financial statements as of June 30, 2016 and 2015 (in thousands):

	<u>Governmental activities</u>		<u>Business-type activities</u>		<u>Total</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Assets:						
Cash	\$ 14,255	\$ 15,180	\$ 29,027	\$ 18,558	\$ 43,282	\$ 33,738
Investments and deposits placed with banks	79,210	82,597	273,042	405,035	352,252	487,632
Loans receivable, net	—	—	206,319	320,325	206,319	320,325
Capital assets	1	1	9,783	1,160	9,784	1,161
Other assets	<u>(14,555)</u>	<u>(11,503)</u>	<u>31,286</u>	<u>40,419</u>	<u>16,731</u>	<u>28,916</u>
Total assets	<u>78,911</u>	<u>86,275</u>	<u>549,457</u>	<u>785,497</u>	<u>628,368</u>	<u>871,772</u>
Deferred outflows of resources	<u>—</u>	<u>—</u>	<u>2,376</u>	<u>2,568</u>	<u>2,376</u>	<u>2,568</u>
Liabilities:						
Due in less than one year	23,614	31,704	54,741	34,383	78,355	66,087
Due in more than one year	<u>108,046</u>	<u>196,840</u>	<u>169,224</u>	<u>194,329</u>	<u>277,270</u>	<u>391,169</u>
Total liabilities	131,660	228,544	223,965	228,712	355,625	457,256
Deferred inflows of resources	<u>—</u>	<u>—</u>	<u>3,459</u>	<u>3,181</u>	<u>3,459</u>	<u>3,181</u>
Net position (deficit):						
Invested in capital assets	1	1	9,783	1,160	9,784	1,161
Restricted	—	—	135,109	141,922	135,109	141,922
Unrestricted position (deficit)	<u>(52,750)</u>	<u>(142,270)</u>	<u>179,517</u>	<u>413,091</u>	<u>126,767</u>	<u>270,821</u>
Total net position	<u>\$ (52,749)</u>	<u>\$ (142,269)</u>	<u>\$ 324,409</u>	<u>\$ 556,173</u>	<u>\$ 271,660</u>	<u>\$ 413,904</u>

Governmental activities net position

The decrease of \$89.5 million in the deficit of the governmental activities is mainly the result of transfers amounting to \$96.9 million from the Operating and Administrative Fund resulting from the sale of certain single and multi-family mortgage loans to a financial institution and a private investor. These mortgage portfolios were sold to partially repay My New Home Program line of credit in order to provide liquidity to GDB.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

Business-type activities net position

The decrease in loans of \$114 was mainly caused by the sale of mortgage loans explained above. The decrease of \$231.7 million in the Net Position of the business-type activities is mainly the result of the transaction previously explained and the recording of a custodial credit risk loss on deposits with GDB amounting to \$116.8 million.

Statement of Activities

The statement of activities shows the sources of the Authority's changes in net position as they arise through its various programs and functions. Programs such as the HUD Programs, HOME Program, and My New Home Program are shown as governmental activities and other programs (Mortgage Loan Insurance and Home Purchase Stimulus Program) are shown as business-type activities. A condensed summary of activities for the fiscal years ended June 30, 2016 and 2015 is shown in the table on the following page (in thousands):

	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Revenues:						
Program revenues:						
Charges for services	\$ —	\$ —	\$ 14,025	\$ 14,746	\$ 14,025	\$ 14,746
Financing and investment	4,076	4,212	25,189	26,318	29,265	30,530
Operating grants, capital grants, and contributions		167,801	—	—	184,521	167,801
Total revenues	<u>4,076</u>	<u>172,013</u>	<u>39,214</u>	<u>41,064</u>	<u>227,811</u>	<u>213,077</u>
Program expenses:						
General government and other	5,923	5,819	—	—	5,923	5,819
Housing assistance programs	190,011	179,063	—	—	190,011	179,063
Operating and administrative	—	—	174,120	36,904	174,120	36,904
Total program expenses	<u>195,934</u>	<u>184,882</u>	<u>174,120</u>	<u>36,904</u>	<u>370,054</u>	<u>221,786</u>
Change in net position before transfers	(7,337)	(12,869)	(134,906)	4,160	(142,243)	(8,709)
Transfers	<u>96,857</u>	<u>269</u>	<u>(96,857)</u>	<u>(269)</u>	<u>—</u>	<u>—</u>
Increase (decrease) in net position	89,520	(12,600)	(231,763)	3,891	(142,243)	(8,709)
Net position (deficit), beginning of year	<u>(142,269)</u>	<u>(129,669)</u>	<u>556,173</u>	<u>552,282</u>	<u>413,904</u>	<u>422,613</u>
Net position (deficit), end of year	<u>\$ (52,749)</u>	<u>\$ (142,269)</u>	<u>\$ 324,410</u>	<u>\$ 556,173</u>	<u>\$ 271,661</u>	<u>\$ 413,904</u>

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

Governmental activities analysis

The increase of \$16.7 million in operating grants and contributions is mainly related to the increase in the grants of the HOME Programs from \$17.1 million in June 30, 2015 to \$29.2 in June 30, 2016. Increase in HOME Program grants is the result of increased activity in construction projects subsidized by the Program. There was also an increase in transfers in amounting to \$96.6 million which is related to the repayment of the line of credit previously discussed.

Business-type activities analysis

One of the most significant changes in the business-type activities is the increase of \$20.7 million in operating and administrative expenses. This increase is mainly related to the loss on sales of loans. As previously explained, these loans were sold to partially repay My New Home Program line of credit in order to provide liquidity to GDB. The other significant change was the recording of a custodial credit risk loss on deposits with GDB amounting to \$116.8 million.

Governmental Fund Results

Following is an analysis of the financial position and results of operations of the Authority's major governmental funds:

HUD Programs – This fund accounts for the U.S. Housing Act Section 8 programs administered by the Authority under the authorization of the U.S. Department of Housing and Urban Development (HUD). Presently, the Authority operates three programs whereby low-income families receive directly or indirectly subsidies to pay for their rent. The housing vouchers program enables families to obtain rental housing in a neighborhood of their choice. The other programs are project-based subsidies whereby housing developers are given incentives to keep their properties available for low and moderate income markets. The expenditures of the HUD Programs increased \$1.1 million from approximately \$147.2 million in 2015 to approximately \$148.3 million in 2016 because additional vouchers assistance was awarded when compared to the previous year.

HOME Program – This fund accounts for funds received from HUD for the administration of the HOME Program. The main purpose of this program is to increase the supply of decent and affordable housing for low and very low-income families.

Revenues increased from approximately \$17.1 million in 2015 to approximately \$25.8 million in 2016 mainly due to increased activity in construction projects subsidized by the Program.

Affordable Housing Subsidy Program – This fund is used to account for the proceeds of specific local revenue sources under the different subsidy programs of the Authority. During the fiscal year ended June 30, 2016, the fund balance decreased by \$4.1 million compared to a decrease of \$20.2 million in the fiscal year ended June 20, 2015. Reasons for a lower decrease in fund balance in fiscal year ended June 30, 2016 are as follows:

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

- Increase of \$3.7 million in Commonwealth appropriations
- Decrease of \$5.2 million in Repayment of disallowed costs
- Increase in Debt service of \$79.2 million
- Decrease in Proceeds from issuance of long-term debt of \$10 million
- Increase in Transfers in of \$96.6 million

The increase in \$3.7 million in Commonwealth appropriations is mainly due to an appropriation of \$4.6 million received by My Own Home Program which was not received in the previous fiscal year. The decrease of \$5.2 million is because the last installment, amounting to \$5.1 million (previous fiscal year installment amounted to \$10.3 million), of the Voluntary Repayment Settlement Agreement with HUD was made during this fiscal year. The increase in Debt Service of \$79.2 million and the increase in transfer in of \$96.6 are both related to the sale of mortgage portfolios to partially repay My New Home Program line of credit in order to provide liquidity to the GDB. Finally, there were no issuances of debt during fiscal year 2016, thus accounting for the decrease of \$10 million in Proceeds from issuance of long-term debt.

Proprietary Fund Results

Following is an analysis of the financial position and results of operations of the major proprietary fund:

Total net position of the Authority's proprietary fund decreased \$231.7 million during the year ended June 30, 2016.

Major factors for the decrease in the fund balance for the year ended June 30, 2016 are as follows:

- Decrease in loans receivable, net of \$114 million
- Increase in operating and administrative expenses of \$20.7 million
- Increase in transfers out of \$96.6 million
- Custodial credit risk loss on deposits with Government Development Bank of \$116 million

Decrease in loans receivable, net of \$114 million is the result of the sale of certain single and multi-family mortgage loans to a financial institution and a private investor. The mortgage portfolios unpaid balance at the time of sale was approximately \$109.1 million, and the net proceeds amounted to approximately, \$89.3 million. Such net proceeds were transferred to My New Home Program, for the payment of the line of credit in order to provide liquidity to the GDB, which was the main cause of the increase in transfers out of \$96.6 million. As a result of the sale of the loans, there was a loss in the transactions amounting to \$18.7 million which mainly accounts for the increase in operating and administrative expenses of \$20.7 million. The custodial credit risk loss on deposits with Government Development Bank amounting to \$116 million was recorded due to the continuing deterioration of the economic and fiscal situation of the Commonwealth of Puerto Rico and GDB.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

Capital Assets

The Authority's investment in capital assets for its business type activities as of June 30, 2016 and 2015 amounted to approximately \$0.9 million and \$1.2 million, respectively, net of accumulated depreciation and amortization. Capital assets include leasehold improvements, information systems, office furniture, equipment, and vehicles.

Authority Debt

The Authority uses long term debt as its main tool to meet its policy objectives. Debt is issued to provide low interest rate mortgage opportunities to qualified buyers. This is achieved through the acquisition of mortgage backed securities that are secured with low income housing assistance mortgages or through providing subsidy for the down payment and/or the principal and interest payments on mortgage loans.

At June 30, 2016 and 2015, total debt outstanding amounted to approximately \$324.1 million and \$419.9 million, respectively. There were no debt issuances during 2016 compared to \$10 million in 2015. Debt repaid, during 2016 and 2015, amounted to approximately \$95.8 million and \$34.5 million, respectively. The credit rating of the Authority's public debt is AA+, as determined by Standards and Poor's in June 2013. Refer to Note 10 to the basic financial statements for additional information on borrowed funds.

Currently Known Facts

The Authority is a component unit of the Government Development Bank for Puerto Rico (GDB), which in turn, is a component unit of the Commonwealth of Puerto Rico (the Commonwealth).

Management of the Authority has identified the financial condition of the GDB, our primary government, and the Commonwealth of Puerto Rico, primary government of the GDB, as an external matter that may affect the ability of the Authority to continue as a going concern. Following is a brief explanation of the financial difficulties facing both entities:

GDB

The GDB has traditionally served as interim lender to the Commonwealth and its public corporations (also referred to herein as instrumentalities) and municipalities in anticipation of the issuance of long term bonds and notes by such entities in the municipal bond market. The GDB has also provided financing to the Commonwealth and its instrumentalities to finance their respective budget deficits, collateral requirements under swap agreements and to meet mandatory payments of obligations.

As a result of this lending function, the GDB traditionally served as the principal source of short term liquidity for the Commonwealth, its public corporations and municipalities.

Loans to the Commonwealth and its instrumentalities constitute a significant portion of the GDB's assets. As a result, the GDB's liquidity and financial condition depends to a large extent on the repayment of loans made to the Commonwealth and its instrumentalities, which face significant fiscal and financial challenges. Conditions that adversely affect the ability of the Commonwealth and its instrumentalities to raise cash

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

(including limited access to capital markets) and repay their interim and other loans to the GDB have an adverse effect on the GDB's liquidity and financial condition. Similarly, conditions that adversely affect the ability of the GDB to raise cash (including limited access to capital markets) or otherwise finance its loan portfolio also have an adverse effect on the Commonwealth and its instrumentalities, as the GDB's ability to continue providing interim financing to the Commonwealth and its instrumentalities is reduced.

The GDB faces significant risks and uncertainties and it currently does not have sufficient liquid financial resources to meet obligations when they come due. Pursuant to enacted legislation, loan disbursements have been suspended, withdrawal and transfer of deposits have been restricted and a moratorium on debt obligations has been imposed, among other measures.

During the fiscal year ended June 30, 2014, and subsequent to the end of such fiscal year, the GDB's liquidity position has been adversely affected by the Commonwealth and its instrumentalities continued operational deficits and lack of capital markets access. These factors have resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding loans with the GDB, which delays, in turn, have limited the GDB's ability to continue providing liquidity to the Commonwealth and its instrumentalities. The Commonwealth's General Fund budget for fiscal year 2014 included approximately \$291.3 million of appropriations to the GDB, including approximately \$270 million of appropriations to repay principal and interest on public sector loans. These appropriations were based on payment schedules proposed by the GDB, which are mostly based on a period of amortization of 30 years, at contractual interest rates. During fiscal year 2014, in order to address a significant revenue shortfall, Executive Order No. 2014-029 was issued, which modified the budgetary appropriation originally approved by the Legislative Assembly of the Commonwealth and thus modified the principal and/or interest payments actually received by the GDB. The amount of the appropriation was reduced from approximately \$291.3 million to \$30.1 million. This reduction was compensated with the funds obtained from the \$3.5 billion General Obligation Bonds issuance of March 2014. For fiscal year 2015, the Commonwealth and the Bank renegotiated the terms of such loans and the Commonwealth appropriated and paid the renegotiated debt service on the public sector loan portfolio of the GDB. During fiscal year 2015 the Bank received \$153.9 million of appropriations.

The budget proposed by the Executive Branch to the Legislative Assembly for fiscal year 2016 included an appropriation for the payment of debt owed by the Commonwealth and certain of its instrumentalities to the GDB of \$261 million, but was amended by the Legislative Assembly to reduce said appropriation to approximately \$18 million, all of which were received. Given the Commonwealth's deteriorating financial condition and ongoing fiscal crisis, there can be no assurance that the Commonwealth will be in a position to make any future appropriations for the payment of debt owed by the Commonwealth and its instrumentalities to the GDB.

COMMONWEALTH OF PUERTO RICO

The Commonwealth currently faces a severe fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Management's Discussion and Analysis (Unaudited)

For the Year Ended June 30, 2016

shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services. The Commonwealth's very high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations have contributed to significant budget deficits during the past several years, which deficits the Commonwealth has financed, further increasing the amount of its debt. More recently, these matters and the Commonwealth's liquidity constraints, among other factors, have adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all. As a result, the Commonwealth has relied more heavily on short-term financings and interim loans from the GDB, and other instrumentalities of the Commonwealth, which reliance has constrained the liquidity of the Commonwealth in general and the GDB in particular, and increased near-term refinancing risk. These factors have also resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding the GDB lines of credit, which delays have limited GDB's ability to continue providing liquidity to the Commonwealth and have caused the GDB to fail to make a principal payment on its debt obligations. These factors are reflected in the deterioration of the Commonwealth's credit ratings. Since June 30, 2014, the principal rating agencies have continued to lower their rating on the general obligation bonds of the Commonwealth, which had already been placed within non-investment grade ratings in February 2014. They also lowered their ratings on the bonds of the Public Building Authority and the "Corporación del Fondo de Interés Apremiante", and on other bonds of various instrumentalities, including GDB, all of which were lowered multiple notches in the grading levels.

Management's Conclusion on Going Concern

The financial difficulties being experienced by GDB and the Commonwealth might have a spillover effect on the operations of the Authority since these entities could try to access our assets in order to alleviate their liquidity problems. As an example, on February and March 2016, the Authority sold mortgage loans to repay a line of credit in order to provide liquidity to GDB. The fiscal and financial difficulties of the Commonwealth and GDB coupled with the fact that the Authority's assets are at the disposition of the GDB and the Commonwealth, which demonstrates the ability of such entities to impose its will on the Authority, causes management of the Authority to conclude that there is substantial doubt about the ability of the Authority to continue as a going concern.

In response to the current and contemplated financial difficulties facing the Commonwealth, GDB and the Authority, Management has implemented the following measures to increase revenues, decrease expenses and enhance liquidity:

- Reducing general and administrative expenses mostly through the decrease of 30% in professional services contracts;
- Negotiating with the Office of Management and Budget and the Puerto Rico Treasury Department the collection of legislative appropriations that have been withheld;
- Entering into co-financing agreements with the Cooperative and Private sector
- Stimulating the Mortgage Insurance Program through the use of a Closing Assistance Program to be financed with the up-front mortgage insurance premiums.

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Management's Discussion and Analysis (Unaudited)
For the Year Ended June 30, 2016

Requests for Information

This financial report is designed to provide a general overview of the Authority finances. Questions concerning the information provided in this report or requests for additional financial information should be addressed to the Office of the Executive Director, Puerto Rico Housing Finance Authority, P.O. Box 71361, San Juan, Puerto Rico, 00936.

* * * * *

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Statement of Net Position
June 30, 2016

	Governmental Activities	Business-type Activities	Total
Assets:			
Cash	\$ 14,255,022	\$ 29,027,366	\$ 43,282,388
Deposits placed with banks	2,151,323	90,867,267	93,018,590
Investments and investment contracts	77,058,489	182,174,599	259,233,088
Loans receivable - net	—	206,318,649	206,318,649
Interest and other receivables	238,422	4,579,205	4,817,627
Due from federal government - net	8,478,478	—	8,478,478
Other assets	—	47,612	47,612
Internal balances	(23,272,158)	23,272,158	—
Real estate available for sale	—	3,387,922	3,387,922
Capital assets, net	1,322	9,782,832	9,784,154
Total assets	<u>78,910,898</u>	<u>549,457,610</u>	<u>628,368,508</u>
Deferred outflows of resources:			
Deferred loss on refundings	—	2,376,146	2,376,146
Liabilities:			
Accounts payable and accrued liabilities	14,088,039	17,086,609	31,174,648
Accrued interest payable	70,486	70,586	141,072
Notes payable to GDB:			—
Due within one year	9,372,393	—	9,372,393
Due in more than one year	104,795,738	—	104,795,738
Notes, bonds and mortgage-backed certificates payable:			
Due within one year	83,595	37,584,235	37,667,830
Due in more than one year	3,250,019	169,223,526	172,473,545
Total liabilities	<u>131,660,270</u>	<u>223,964,956</u>	<u>355,625,226</u>
Deferred inflows of resources:			
Unearned revenue	—	3,459,028	3,459,028
Net position (deficit):			
Net investment in capital assets	1,322	9,782,832	9,784,154
Restricted for:			
Affordable housing programs	—	30,455,405	30,455,405
Mortgage loan insurance	—	77,387,721	77,387,721
Debt service	—	22,511,243	22,511,243
Other housing programs	—	4,755,156	4,755,156
Unrestricted (deficit)	(52,750,694)	179,517,415	126,766,721
Total net position (deficit)	<u>\$ (52,749,372)</u>	<u>\$ 324,409,772</u>	<u>\$ 271,660,400</u>

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Statement of Activities
June 30, 2016

	Program Revenues			Net (expenses) revenues and changes in net position			
	Expenses	Charges for Services - fees, commissions, and others	Charges for Services - financing and investment	Operating grants and contributions	Governmental activities	Business-type activities	Total
Functions/programs:							
Governmental activities:							
General government and other	\$ 5,923,076	\$ —	\$ —	\$ —	\$ (5,923,076)	\$ —	\$ (5,923,076)
Housing assistance program	190,010,737	—	4,076,107	184,520,623	(1,414,007)	—	(1,414,007)
Total governmental activities	195,933,813	—	4,076,107	184,520,623	(7,337,083)	—	(7,337,083)
Business-type activities:							
Operating and administrative	174,120,274	14,025,135	25,188,760	—	—	(134,906,379)	(134,906,379)
Total business-type activities	174,120,274	14,025,135	25,188,760	—	—	(134,906,379)	(134,906,379)
Total functions/programs	\$ 370,054,087	\$ 14,025,135	\$ 29,264,867	\$ 184,520,623	(7,337,083)	(134,906,379)	(142,243,462)
Transfers in (out) - net					96,856,804	(96,856,804)	—
Change in net position					89,519,721	(231,763,183)	(142,243,462)
Net position (deficit) - Beginning of year					(142,269,093)	556,172,955	413,903,862
Net position (deficit) - End of year					\$ (52,749,372)	\$ 324,409,772	\$ 271,660,400

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Balance Sheet – Governmental Funds

June 30, 2016

Assets	HUD Programs	HOME Programs	Affordable Housing Subsidy Programs	Total
Cash	\$ 473,058	\$ 447,518	\$ 13,334,446	\$ 14,255,022
Deposits placed with banks	—	—	2,151,323	2,151,323
Investments and investment contracts	—	—	77,058,489	77,058,489
Interest and other receivables	3,033	—	235,389	238,422
Due from federal government - net	921,503	7,556,975	—	8,478,478
Total assets	<u>\$ 1,397,594</u>	<u>\$ 8,004,493</u>	<u>\$ 92,779,647</u>	<u>\$ 102,181,734</u>
Liabilities and Fund Balances				
Liabilities:				
Accounts payable and accrued liabilities	\$ 434,454	\$ 6,584,115	\$ 7,069,470	\$ 14,088,039
Due to Government Development Bank for Puerto Rico	—	—	2,393	2,393
Due to other funds	963,140	1,420,378	20,888,641	23,272,159
Total liabilities	1,397,594	8,004,493	27,960,504	37,362,591
Deferred inflows of resources:				
Unearned revenue	—	3,422,172	—	3,422,172
Fund balances (deficit):				
Restricted for affordable housing programs	—	—	64,819,143	64,819,143
Deficit	—	(3,422,172)	—	(3,422,172)
Total fund balances (deficit)	—	(3,422,172)	64,819,143	61,396,971
Total liabilities and fund balances	<u>\$ 1,397,594</u>	<u>\$ 8,004,493</u>	<u>\$ 92,779,647</u>	<u>\$ 102,181,734</u>

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Position

June 30, 2016

Amounts reported for governmental activities in the statement of net position are different because:

Total fund balances	\$ 61,396,971
Capital assets used in governmental activities are not financial resources and, therefore, are not report in the funds	1,322
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not report in the funds:	
Note payable due in more than one year	(3,333,613)
Due to Government Development Bank for Puerto Rico due in more than one year	(114,165,738)
Accrued interest payable is not due and payable in the current period	(70,486)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds	<u>3,422,172</u>
Net position of governmental activities	\$ <u><u>(52,749,372)</u></u>

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

*Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
For the Year Ended June 30, 2016*

	<u>HUD Programs</u>	<u>HOME Programs</u>	<u>Affordable Housing Subsidy Programs</u>	<u>Total</u>
Revenues:				
Intergovernmental-federal government	\$ 148,302,029	\$ 20,643,281	\$ —	\$ 168,945,310
Other income	5,669	5,126,535	1,331,660	6,463,864
Interest income on investment and investment contracts	—	—	4,143,583	4,143,583
Commonwealth appropriation for repayment of bonds or housing assistance programs	—	—	5,669,768	5,669,768
Net decrease in fair value of investments	—	—	(67,476)	(67,476)
Interest income on deposits placed with banks	—	—	19,509	19,509
Total revenues	<u>148,307,698</u>	<u>25,769,816</u>	<u>11,097,044</u>	<u>185,174,558</u>
Expenditures:				
Current:				
Housing assistance programs	143,224,146	28,418,636	10,848,369	182,491,151
Repayment of disallowed costs	—	—	5,126,235	5,126,235
General government and other	5,083,552	773,352	66,010	5,922,914
Debt service:				
Principal	—	—	89,401,716	89,401,716
Interest	—	—	6,651,793	6,651,793
Total expenditures	<u>148,307,698</u>	<u>29,191,988</u>	<u>112,094,123</u>	<u>289,593,809</u>
Deficiency of revenues under expenditures	—	(3,422,172)	(100,997,079)	(104,419,251)
Other financing sources:				
Transfers in	—	—	96,856,804	96,856,804
Total other financing sources	<u>—</u>	<u>—</u>	<u>96,856,804</u>	<u>96,856,804</u>
Net change in fund balances	—	(3,422,172)	(4,140,275)	(7,562,447)
Fund balance — beginning of year	—	—	68,959,418	68,959,418
Fund balance (defecit) — end of year	<u>\$ —</u>	<u>\$ (3,422,172)</u>	<u>\$ 64,819,143</u>	<u>\$ 61,396,971</u>

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

*Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances –
Governmental Funds to the Statement of Activities*

For the Year Ended June 30, 2016

Amounts reported for governmental activities in the statement of activities
are different because:

Net changes in fund balance — total governmental funds \$ (7,562,447)

The issuance of long-term debt (e.g. bonds, notes) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect in net assets. This amount is the net effect of these differences in the treatment of long-term debt and related items as follows:

Principal payments	89,401,716
Increase in long term accrued interest payable due to Government Development Bank for Puerto Rico	(867,793)

Governmental funds report capital outlays as expenditures; however, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expenses. This is the amount by which depreciation exceeded capital outlays in the current period (162)

Disallowed costs previously reported in the statement of activities that are being reported as expenditures in the governmental funds 5,126,235

Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the governmental funds 3,422,172

Change in net position of governmental activities \$ 89,519,721

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Balance Sheet – Proprietary Fund – Operating and Administrative Fund

June 30, 2016

Assets

Current assets:

Cash	\$	9,077,344
Loans receivable - net		2,053,536
Interest receivable		604,086
Other receivables		2,905,754
Other assets		47,612
Due from other funds		23,272,158

Restricted:

Cash		19,950,022
Deposits placed with banks		78,927,253
Investments and investments contracts		13,286,495
Loans receivable - net		663,360
Interest receivable		1,013,520
Other receivables		55,845

Total current assets 151,856,985

Noncurrent assets:

Investments and investments contracts		17,628,800
Loans receivable - net		137,461,998
Real estate available for sale		3,284,214
Capital assets		9,782,832

Restricted:

Deposits placed with banks		11,940,014
Investments and investments contracts		151,259,304
Loans receivable - net		66,139,755
Real estate available for sale		103,708

Total noncurrent assets 397,600,625

Total assets 549,457,610

Deferred outflows of resources

Deferred loss on refundings		<u>2,376,146</u>
-----------------------------	--	------------------

Total assets and deferred outflows of resources \$ 551,833,756

(continues)

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Balance Sheet – Proprietary Fund – Operating and Administrative Fund

June 30, 2016

Current liabilities:	
Current liabilities payable from unrestricted assets:	
Accounts payable and accrued liabilities	\$ 9,085,721
Current liabilities payable from restricted assets:	
Accrued interest payable	70,586
Accounts payable and accrued liabilities	331,269
Allowance for losses on mortgage loan insurance	7,669,619
Bonds, notes and mortgage-backed certificates payable	<u>37,584,235</u>
Total current liabilities payable from restricted assets:	<u>45,655,709</u>
Non-current liabilities payable from restricted assets:	
Bonds, notes and mortgage-backed certificates payable	169,223,526
Total liabilities	223,964,956
Deferred inflows of resources	
Unearned revenue	<u>3,459,028</u>
Total liabilities and deferred inflows of resources	227,423,984
Net position:	
Net investment in capital assets	9,782,832
Restricted for:	
Mortgage loan insurance	77,387,721
Affordable housing programs	30,455,405
Debt service	22,511,243
Other housing programs	4,755,156
Unrestricted	<u>179,517,415</u>
Total net position	<u>324,409,772</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 551,833,756</u>

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Statement of Revenues, Expenses, and Change in Net Position – Proprietary Fund –

Operating and Administrative Fund

For the Year Ended June 30, 2016

	Operating and Administrative Fund
Operating revenues:	
Investment Income:	
Interest income on investment and investment contracts	\$ 6,786,638
Interest income on deposits placed with banks	1,488,714
Net increase in fair value of investments	<u>1,560,875</u>
Total investment income	9,836,227
Interest income on loans	<u>15,352,533</u>
Total investment income and interest income on loans	25,188,760
Noninterest income:	
Commitment, guarantee, service, and administrative fees	7,799,702
Other income	1,484,150
Mortgage loans insurance premiums	4,392,244
Release of allowance for loan losses	<u>349,039</u>
Total noninterest income	<u>14,025,135</u>
Total operating revenues	39,213,895
Operating expenses:	
Interest expense - bonds, notes and mortgage-backed certificates	13,772,934
Other noninterest expenses:	
Salaries and fringe benefits	10,714,980
Legal and professional fees	2,807,404
Occupancy and equipment costs	2,319,312
Office and administrative	2,205,777
Other real estate owned maintenance and related expenses	632,864
Net loss from sale of foreclosed real estate available for sale	1,106,969
Provision for losses on mortgage loans insurance	3,373,574
Provision for losses on OREO	691,055
Depreciation and amortization	569,498
Subsidy and trustee fees	<u>274,933</u>
Total noninterest expense	<u>24,696,366</u>
Total operating expenses	<u>38,469,300</u>
Operating income	744,595
Nonoperating expenses	
Custodial credit risk loss on deposits with Governmental Development Bank	(116,506,240)
Contributions to others	(346,674)
Net loss on sale of loans	(18,798,060)
Transfers out	<u>(96,856,804)</u>
Change in net position	(231,763,183)
Net position — beginning of year	<u>556,172,955</u>
Net position — end of year	<u>\$ 324,409,772</u>

See accompanying notes to basic financial statements.

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Statement of Cash Flows – Proprietary Fund – Operating and Administrative Fund
For the Year Ended June 30, 2016

Cash flows from operating activities:	
Cash received from interest on mortgage and construction loans	\$ 15,352,533
Cash paid for mortgage and construction loans originated	(31,190,583)
Principal collected on mortgage and construction loans	35,412,728
Proceeds from sale of mortgage and construction loans	89,395,620
Cash received from other operating noninterest income	9,283,852
Cash received from mortgage loans insurance premiums	4,375,561
Cash paid for noninterest expenses	(9,351,111)
Cash received from transit account	174,898
Cash payments for salaries and fringe benefits	(10,682,942)
Internal balances	<u>(1,155,499)</u>
Net cash used in operating activities	101,615,057
Cash flows from noncapital financing activities:	
Payments of bonds payable	(16,534,448)
Interest paid	(4,153,936)
Contribution to others	(346,674)
Custodial credit risk loss	(1,174,207)
Transfers out	<u>(96,856,804)</u>
Net cash used in noncapital financing activities	(119,066,069)
Cash flows from capital and related financing activities:	
Acquisition of capital assets	<u>(312,020)</u>
Net cash used in capital and related financing activities	(312,020)
Cash flows from investing activities:	
Purchase of investments	(1,441,472)
Proceeds from redemptions of investments	25,116,451
Net change in deposits placed with banks	(5,453,168)
Cash received from interest on investments	8,660,289
Interest received on other than housing program loans	1,335
Proceeds from sale of real estate held for sale	1,885,079
Acquisition of real estate held for sale	<u>(536,555)</u>
Net cash provided by investing activities	28,231,959
Net change in cash	10,468,927
Cash, beginning of year	<u>18,558,439</u>
Cash, end of year	<u>\$ 29,027,366</u>
Reconciliation to balance sheet — proprietary funds:	
Cash — unrestricted	\$ 9,077,344
Cash — restricted	<u>19,950,022</u>
Total cash at year-end	<u>\$ 29,027,366</u>

(continues)

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Statement of Cash Flows – Proprietary Fund – Operating and Administrative Fund
For the Year Ended June 30, 2016

Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 744,595
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	569,498
Net decrease in fair value of investments	(1,560,874)
Interest income on investments	(8,275,352)
Capitalized interest and deferred amortization on loans	(886,918)
Tax credit fees	(153,139)
Provision for loan losses	(349,039)
Gain on sale of real estate held for sale	1,106,969
Provision (release) for losses on mortgage loans insurance	3,373,574
Provision (release) for losses on real estate held for sale	691,055
Net decrease in market value of real estate held for sale	741,102
Interest expense	13,772,934
Accrued interest on mortgage and construction loans	901,236
Housing program loans originated	(31,190,583)
Collections of mortgage and construction loans	35,412,728
Proceeds from sale of mortgage and construction loans	89,395,620
Other accounts receivable and prepaid expenses	94,107
Accounts payable and accrued liabilities	(1,823,893)
Account payable - transit account	174,898
Accrued salaries and fringe benefits	32,038
Internal balances	(1,155,499)
Net cash provided by operating activities	<u>\$ 101,615,057</u>

See accompanying notes to the basic financial statements.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

1. REPORTING ENTITY

Puerto Rico Housing Finance Authority (the Authority) is a component unit of Government Development Bank for Puerto Rico (GDB), which is a component unit of the Commonwealth of Puerto Rico (the Commonwealth). The Authority operates under Law 103 of August 11, 2011, to provide public and private housing developers with interim and permanent financing through mortgage loans for the construction, improvement, operation, and maintenance of rental housing for low and moderate-income families. The Authority also issues bonds and notes, the proceeds of which are deposited in separate trusts and generally invested in mortgage-backed securities collateralized by mortgage loans on properties located in Puerto Rico purchased by low and moderate-income families or used to provide subsidies to such families for the acquisition of their primary residence. The Authority is authorized by the U.S. Department of Housing and Urban Development (HUD) to administer the U.S. Housing Act Section 8 program in Puerto Rico, to administer the HOME Investment Partnerships (HOME) Program, and to act as an approved mortgagor, both for multifamily rental units and for single-family homes. In addition, it is an authorized issuer of Government National Mortgage Association (GNMA) mortgage-backed securities and is Puerto Rico's State Credit Agency for the Low-Income Housing Tax Credit Program under Section 42 of the U.S. Internal Revenue Code.

The Authority is the Public Housing Authority in charge of implementing the Low-Income Housing Tax Credit Program in Puerto Rico. The tax credits provide a financial incentive to construct, rehabilitate, and operate rental housing for low-income tenants. A 10-year tax credit is available for each unit set-aside for low-income use as long as eligible households occupy a specific portion of units in a building or project. The rents charged on the set-aside units are restricted and eligible households occupy them or such units becoming vacant must be held open for eligible households for at least 15 years, plus a minimum of 15 additional years that the Authority requires.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Authority conform to U.S. generally accepted accounting principles (GAAP).

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses/expenditures during the reported period. Actual results could differ from those estimates.

(a) Government-Wide and Fund Financial Statements

Government-Wide Financial Statements – The statement of net position and the statement of activities report information on all activities of the Authority. The effect of interfund balances has been removed from the government-wide statement of net position, except for the residual amounts due between governmental and business-type activities. Interfund charges for services

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

among functions of the government-wide statement of activities have not been eliminated. The Authority's activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services or interest earned on investment securities. Following is a description of the Authority's government-wide financial statements.

The statement of net position presents the Authority's assets, deferred outflows of resources, liabilities and deferred inflows of resources using the accrual basis of accounting with the difference reported as net position. Net position is reported in three categories:

- Net investment in capital assets consist of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances of bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any.
- Restricted net position results when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or are imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net position consists of net position that does not meet the definition of the two preceding categories. Unrestricted net position often is designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net position often has constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include (1) interest income on loans and investments, changes in the fair value of investments, and fees and charges to customers for services rendered or for privileges provided and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Other items not meeting the definition of program revenues are reported as general revenues.

Fund Financial Statements – Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. The financial activities of the Authority that are reported in the accompanying basic financial statements have been classified into governmental and proprietary funds.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental and proprietary funds are reported as separate columns in the fund financial statements, with nonmajor funds being combined into a single column.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

(b) Fund Balances

Fund balances of the governmental funds are reported as restricted because of the constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, or law or regulations of other governments.

(c) Measurement Focus, Basis of Accounting, and Financial Statements Presentation

Government-Wide Financial Statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

Governmental Funds' Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough, thereafter, to pay liabilities of the current period. For this purpose, the Authority considers revenues to be available if they are collected within 120 days after the end of the fiscal year. Principal revenue sources considered susceptible to accrual include federal funds to be received by the HUD Programs and HOME Program. Other revenues are considered to be measurable and available only when cash is received. Expenditures generally are recorded when the liability is incurred, as under accrual accounting. However, principal and interest on general long-term debt, claims and judgments, and compensated absences are recorded only when payment is due. Capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Governmental Funds – The following governmental activities of the Authority are reported as major governmental funds:

- **HUD Programs** – This special revenue fund accounts for the subsidy to low and moderate-income families for the rental of decent and safe dwellings under the U.S. Housing Act Section 8 programs.
- **HOME Programs** – This special revenue fund is used to account for the specific revenue sources related to the HOME Program. The objectives of this special revenue fund include (1) expanding the supply of decent and affordable housing, particularly housing for low and very low-income families; (2) strengthening the abilities of state and local governments to design and implement strategies for achieving adequate supplies of decent, affordable housing; (3) providing financial and technical assistance to participating jurisdictions, including the development of model programs for affordable low-income housing; and (4) extending and strengthening partnerships among all levels of government

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

and the private sector, including for-profit and nonprofit organizations, in the production and operation of affordable housing.

- **Affordable Housing Subsidy Programs** – This special revenue fund is used to account for the proceeds of specific local revenue sources under the different subsidy programs of the Authority, which are as follows:
 - **Affordable Housing Mortgage Subsidy Programs (AHMSP) Act No. 124** – Under this program, the Authority commits to provide a subsidy for the down payment and/or the principal and interest payments on mortgage loans originated under a predetermined schedule of originations. Loans originated, as well as servicing, are kept by the originating financial institution. There was no open schedule of originations under this program as of June 30, 2016.
 - **My New Home Program** – This program has revenues provided by Act No. 122 of August 6, 2010, as amended, which assigned to the Authority, for a period of seven years, a portion of no less than 80% of the unreserved monies and other liquid funds abandoned or unclaimed in financial institutions that will be transferred to the general fund of the Commonwealth. This program provides subsidies to eligible families for the purchase of a principal residence through reimbursement of origination and closing costs.
 - **My Own Home Program** – This program has revenues provided by Act No. 34 of June 26, 2014. This program provides subsidies to eligible families for the purchase of a principal residence through reimbursement of origination and closing costs.
 - **New Secure Housing Program** – This program provided federal and local resources directed to plan, coordinate, and develop the construction of new housing units as a replacement for those destroyed by Hurricane Georges in 1998, and to attend to the housing needs of those families living in hazard-prone areas. No additional subsidies are expected to be provided under this program.

Proprietary Fund Financial Statements – The financial statements of the proprietary fund are reported using the economic resources measurement focus and the accrual basis of accounting.

The proprietary fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses are those that result from the Authority providing the services that correspond to their principal ongoing operations. Operating revenues are generated from lending, investing, fiscal agency services, and other related activities. Operating expenses include interest expense, any provision for losses on loans, advances, or guarantees, and all general and administrative expenses, among other. Revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

Proprietary Fund – The following business-type activities of the Authority are reported as a single-major proprietary fund:

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

- **Operating and Administrative** – The Operating and Administrative fund accounts for all the enterprise activities of the Authority. Within this fund, the Authority has the following programs:
 - **Mortgage Trust III** – Initially, this program provided resources for the financing of low and moderate-income families' purchase of residential housing from the proceeds of bond issuances. Currently, the program has monies in an escrow to be used for the payment through maturity of bonds with a carrying amount of approximately \$77 million.
 - **Home Purchase Stimulus Program** – This program was created as part of Act No. 9, approved on March 9, 2009, to help families in the acquisition of a new or existing house through the issuance of a second mortgage.
 - **Mortgage-Backed Certificates 2006 Series A** – The program received resources from the proceeds of the issuance of mortgage-backed certificates (the Mortgage-Backed Certificates), which were used to defease the Collateralized Mortgage Revenue Bonds 1994 Series A and the Single Family Mortgage Portfolio I and Portfolio IV bonds.

The Mortgage-Backed Certificates are limited obligations of the Authority, payable from and secured by certain mortgage-backed securities guaranteed by Government National Mortgage Associations (GNMA) and Federal National Mortgage Association (FNMA) (the Mortgage-Backed Securities), as well as from moneys in certain funds and accounts established in the trust indenture for the issuance of the Mortgage-Backed Certificates. The Mortgage-Backed Securities are backed by mortgage loans made by participating lending institutions to low and moderate-income families to finance the purchase of qualified single-family residential housing units in Puerto Rico under the Authority's AHMSP Act No. 124. Each class of Mortgage-Backed Certificates will be paid from a separate and distinct stream of principal and interest payments from designated mortgage loans per class of Mortgage-Backed Certificates, as paid through the corresponding Mortgage-Backed Securities into which the class mortgage loans are pooled, as well as moneys deposited in certain funds and accounts established in the trust indenture. The scheduled and unscheduled principal payments derived from class mortgage loans and interest will be paid on a monthly basis. The rates of principal payments on each Mortgage-Backed Certificate will depend on the rates of principal payments, including prepayments, on the related class mortgage loans. The rates of the payments, including prepayments, on the mortgage loans are dependent on a variety of economic and social factors, including the level of market interest rates.

- **Mortgage Loans Insurance** – The mortgage loan insurance program was created to provide mortgage credit insurance to low and moderate-income families on loans originated by the Authority and other financial institutions.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

- **Land Acquisition and Construction Loan Insurance (Act No. 89)** – The land acquisition and construction loan insurance program provides mortgage credit insurance to low and moderate-income families for the purchase of land lots. The program is financed through legislative appropriations and proceeds from mortgage insurance premiums and any other income derived from this insurance activity. Under this program, the Authority is authorized to commit the good faith and credit of the Commonwealth up to \$5 million for the issuance of debenture bonds.
- **Single-Family Mortgage Revenue Bonds Portfolio XI** – Under this program, as part of the Authority’s AHMSP, bonds were issued and the proceeds were mainly used to purchase mortgage-backed securities collateralized by loans originated to finance low and moderate-income families’ purchase of residential housing units.

(d) Fair Value Measurement

The Authority categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

(e) Investments and Investment Contracts

Investments and investment contracts are carried at fair value, except for money market instruments and participating investment contracts with a remaining maturity at the time of purchase of one year or less and nonparticipating investment contracts (guaranteed investment contracts), which are carried at cost, and investment positions in 2a-7 like external investment pools, which are carried at the pools’ share price. The Authority’s investments and investment contracts have recurring fair value measurements as of June 30, 2016 using quoted market prices (Level 1 inputs). Realized gains and losses from the sale of investments and unrealized changes in the fair value of outstanding investments are included in net increase (decrease) in fair value of investments.

In accordance with the specific requirements established in the bond indentures, the Authority has invested certain debt proceeds in U.S. government obligations, U.S. and Puerto Rico mortgage-backed securities, and investment contracts. These U.S. government obligations, mortgage-backed securities, and investment contracts are held in custody by the trustee of the bond issue in the name of the Authority.

(e) Loans Receivable and Allowance for Loan Losses

Loans are presented at the outstanding unpaid principal balance reduced by an allowance for loan losses. Loans are measured for impairment when it is probable that all amounts, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement. Interest accrual ceases when collectability is uncertain, for single-family loans is

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

90 days past due, for multiple family loans is 180 past due and for construction loans when it is considered impaired. Once a loan is placed in nonaccrual status, all accrued but uncollected interest is reversed against current interest income. Interest income on nonaccrual loans, is thereafter, recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when management has adequate evidence to believe that the loans will be performing as contracted.

The allowance for loan losses is established through provisions recorded as an operating expense. This allowance is based on the evaluation of the risk characteristics of the loan or loan portfolio, including such factors as the nature of the individual credit outstanding, past loss experience, known and inherent risks in the portfolios, and general economic conditions. Charge-offs are recorded against the allowance when management believes that the collectibility of the principal is unlikely. Recoveries of amounts previously charged off are credited to the allowance. Because of uncertainties inherent in the estimation process, management's estimate of credit losses in the outstanding loans receivable portfolio and the related allowance may change in the near future.

Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Authority will be unable to collect all amounts due according to the contractual terms of the loan agreement. Interest income and cash receipts on impaired loans are accounted for predominantly in the same manner as nonaccrual loans.

(f) Real Estate Available for Sale

Real estate available for sale comprises properties acquired through foreclosure proceedings. It also includes loans that are treated as if the underlying collateral had been foreclosed because the Authority has taken possession of the collateral, even though legal foreclosure or repossession proceedings have not taken place. Those properties are carried at the lower of cost or fair value, which is established by a third-party professional assessment or based upon an appraisal, minus estimated costs to sell. At the time of acquisition of properties in full or in partial satisfaction of loans, any excess of the loan balance over the fair value of the properties, minus estimated costs to sell is charged against the allowance for loan losses. Subsequent declines in the value of real estate available for sale are charged to expense. Gain or loss on sale of real estate available for sale are included within revenues or expenses in the accompanying statement of activities, and within noninterest income or noninterest expense in the accompanying statement of revenues, expenses, and change in net position.

(g) Capital Assets

Capital assets, which include leasehold improvements, information systems, office furniture and equipment and vehicles, are reported in the governmental activities and business-type activities columns in the government-wide financial statements and in the proprietary fund. Capital assets are defined by the Authority as assets, which have a cost of \$500 or more at the date of acquisition and have an expected useful life of three or more years. Purchased capital

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

assets are valued at historical cost. Donated fixed assets are recorded at their acquisition value refers to the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date. The costs of normal maintenance and repairs that do not add to the asset's value or materially extend the asset's useful life are not capitalized.

Capital assets are depreciated on the straight-line method over the assets' estimated useful lives. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Generally, estimated useful lives are as follows:

Leasehold improvements	Lesser of 10 years or lease term
Office furniture and equipment	Five years
Information systems	Three years
Vehicles	Five years

(h) Compensated Absences

The employees of the Authority earn 30 days of vacation and 18 days of sick leave annually. Vacation and sick leave may be accumulated up to a maximum of 72 and 90 days, respectively. In the event of employee resignation, an employee is paid for accumulated vacation and sick leave days up to the maximum allowed. The proprietary fund financial statements and the government-wide financial statements present the cost of accumulated vacation and sick leave as a liability. In the governmental funds, such liability is recorded only for the current portion.

(i) Allowance for Losses on Mortgage Loans Insurance

The estimated liability for losses on mortgage loans insurance is based on management's evaluation of potential losses on insurance claims after considering economic conditions, fair value of related property, and other pertinent factors. Such amount is, in the opinion of management, adequate to cover estimated future probable mortgage loans insurance losses. Actual losses for mortgage loans insurance are charged, and recoveries, if any, are credited to the estimated liability for losses on mortgage loans insurance. Because of uncertainties inherent in the estimation process, management's estimate of losses in the outstanding loans guarantee portfolio and the related liability may change in the near future.

(j) Loan Origination Costs and Commitment Fees

Loan origination and commitment fees are recognized as revenues in the period received. Direct origination costs are recognized as an expense in the period incurred.

(k) Transfers of Receivables

Transfers of receivables are accounted and reported as a sale if the Authority's continuing involvement with those receivables is effectively terminated. This approach distinguishes transfers of receivables that are sales from transfers that are collateralized borrowings.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

The Authority's continuing involvement is considered to be effectively terminated if all of the following criteria are met (i) the transferee's ability to subsequently sell or pledge the receivables is not significantly limited by constraints imposed by the Authority, either in the transfer agreement or through other means; (ii) the Authority does not have the option or ability to unilaterally substitute for or reacquire specific accounts from among the receivables transferred, except in certain limited circumstances; (iii) the sale agreement is not cancelable by either party, including cancellation through payment of a lump sum or transfer of other assets or rights; and (iv) the receivables and the cash resulting from their collection have been isolated from the Authority.

The Authority services loans for investors and receives servicing fees generally based on stipulated percentages of the outstanding principal balance of such loans. Loan servicing fees, late charges, and other miscellaneous fees are recognized as revenues as the related mortgage payments are collected, net of fees due to any third-party servicers. No servicing asset is recognized since fees are considered adequate compensation.

(l) Mortgage Loans Insurance Premiums

Premiums on insured mortgage loans are recognized as earned.

(m) Risk Financing

To minimize its risk of loss, the Authority purchases insurance coverage for public liability, hazard, automobile, crime, and bonding, as well as medical and workmen's insurance for employees. The selection of the insurer has to be approved by the Public Insurance Office of the Puerto Rico Treasury Department. Insurance coverage is updated annually to account for changes in operating risk. For the last three years, insurance settlements have not exceeded the amount of coverage.

(n) Deferred Inflows of Resources

The Authority has unearned revenue of approximately \$3.5 million related to premiums on insured mortgage loans paid in advance as of June 30, 2016.

3. GOING CONCERN, DEPOSITS IN GDB AND CUSTODIAL CREDIT RISK LOSS

GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards (GASB 56)*, establishes that the continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Indicators such as negative trends in operating losses and negative cash flows, possible financial difficulties such as nonpayment or

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

default of debt and/or restructurings or noncompliance with capital or reserve requirements, and internal or external matters impacting the governmental entity's ability to meet its obligations as they become due, are factors that are considered in this evaluation.

Management's evaluation of the Authority's going concern has identified the financial condition of the GDB, the Authority's primary government, and the Commonwealth, primary government of GDB, as an external matter that may affect the ability of the Authority to continue as a going concern. Following is a brief explanation of the financial difficulties facing both entities:

GDB

The GDB has traditionally served as interim lender to the Commonwealth and its public corporations (also referred to herein as instrumentalities) and municipalities in anticipation of the issuance of long term bonds and notes by such entities in the municipal bond market. The GDB has also provided financing to the Commonwealth and its instrumentalities to finance their respective budget deficits, collateral requirements under swap agreements and to meet mandatory payments of obligations.

As a result of this lending function, the GDB traditionally served as the principal source of short term liquidity for the Commonwealth, its public corporations and municipalities.

Loans to the Commonwealth and its instrumentalities constitute a significant portion of the GDB's assets. As a result, the GDB's liquidity and financial condition depends to a large extent on the repayment of loans made to the Commonwealth and its instrumentalities, which face significant fiscal and financial challenges. Conditions that adversely affect the ability of the Commonwealth and its instrumentalities to raise cash (including limited access to capital markets) and repay their interim and other loans to the Bank have an adverse effect on the GDB's liquidity and financial condition. Similarly, conditions that adversely affect the ability of the GDB to raise cash (including limited access to capital markets) or otherwise finance its loan portfolio also have an adverse effect on the Commonwealth and its instrumentalities, as the GDB's ability to continue providing interim financing to the Commonwealth and its instrumentalities is reduced.

The GDB faces significant risks and uncertainties and it currently does not have sufficient liquid financial resources to meet obligations when they come due, as further described below. As discussed below, pursuant to recently enacted legislation, the Governor has ordered the suspension of loan disbursements by the GDB, imposed restrictions on the withdrawal and transfer of deposits from the GDB, and imposed a moratorium on debt obligations of the GDB, among other measures.

During the fiscal year ended June 30, 2014, and subsequent to the end of such fiscal year, the GDB's liquidity position has been adversely affected by the Commonwealth and its instrumentalities' continued operational deficits and lack of capital markets access. These factors have resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding loans with the GDB, which delays, in turn, have limited the GDB's ability to continue providing liquidity to the Commonwealth and its instrumentalities. The Commonwealth's General Fund budget for fiscal year 2014 included approximately \$291.3 million of appropriations to the

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

GDB, including approximately \$270 million of appropriations to repay principal and interest on public sector loans. These appropriations were based on payment schedules proposed by the GDB, which are mostly based on a period of amortization of 30 years, at contractual interest rates. During fiscal year 2014, in order to address a significant revenue shortfall, Executive Order No. 2014-029 was issued, which modified the budgetary appropriation originally approved by the Legislative Assembly of the Commonwealth and thus modified the principal and/or interest payments actually received by the GDB. The amount of the appropriation was reduced from approximately \$291.3 million to \$30.1 million. This reduction was compensated with the funds obtained from the \$3.5 billion General Obligation Bonds issuance of March 2014. For fiscal year 2015, the Commonwealth and the GDB renegotiated the terms of such loans and the Commonwealth appropriated and paid the renegotiated debt service on the public sector loan portfolio of the GDB. During fiscal year 2015 the GDB received \$153.9 million of appropriations.

The budget proposed by the Executive Branch to the Legislative Assembly for fiscal year 2016 included an appropriation for the payment of debt owed by the Commonwealth and certain of its instrumentalities to the Bank of \$261 million, but was amended by the Legislative Assembly to reduce said appropriation to approximately \$18 million, all of which were received. Given the Commonwealth's deteriorating financial condition and ongoing fiscal crisis, there can be no assurance that the Commonwealth will be in a position to make any future appropriations for the payment of debt owed by the Commonwealth and its instrumentalities to the GDB.

COMMONWEALTH OF PUERTO RICO

The Commonwealth currently faces a severe fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services. The Commonwealth's very high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations have contributed to significant budget deficits during the past several years, which deficits the Commonwealth has financed, further increasing the amount of its debt. More recently, these matters and the Commonwealth's liquidity constraints, among other factors, have adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all. As a result, the Commonwealth has relied more heavily on short-term financings and interim loans from GDB, and other instrumentalities of the Commonwealth, which reliance has constrained the liquidity of the Commonwealth in general and GDB in particular, and increased near-term refinancing risk. These factors have also resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding GDB lines of credit, which delays have limited GDB's ability to continue providing liquidity to the Commonwealth and have caused GDB to fail to make a principal payment on its debt obligations. These factors are reflected in the deterioration of the Commonwealth's credit ratings. Since June 30, 2014, the principal rating agencies have continued to lower their rating on

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

the general obligation bonds of the Commonwealth, which had already been placed within non-investment grade ratings in February 2014.

Complete financial statements of the Authority's primary governments can be obtained directly by contacting their respective administrative offices at:

Department of the Treasury of the Commonwealth of Puerto Rico
Área de Contabilidad Central
P.O. Box 9024140, San Juan, PR 00902

Government Development Bank for Puerto Rico
P.O. Box 42001, San Juan, PR 00940-2001

Management's Conclusion on Going Concern

The financial difficulties being experienced by GDB and the Commonwealth might have a spillover effect on the operations of the Authority since these entities could try to access our assets in order to alleviate their liquidity problems. As an example, on February and March 2016, the Authority sold mortgage loans to repay a line of credit in order to provide liquidity to GDB. The fiscal and financial difficulties of the Commonwealth and GDB coupled with the fact that the Authority's assets are at the disposition of the GDB and the Commonwealth, which demonstrates the ability of such entities to impose its will on the Authority, causes management of the Authority to conclude that there is substantial doubt about the ability of the Authority to continue as a going concern.

In response to the current and contemplated financial difficulties facing the Commonwealth, GDB and the Authority, Management has implemented the following measures to increase revenues, decrease expenses and enhance liquidity:

- Reducing general and administrative expenses mostly through the decrease of of 30% in professional services contracts;
- Negotiating with the Office of Management and Budget and the Puerto Rico Treasury Department the collection of legislative appropriations that have been withheld;
- Entering into co-financing agreements with the Cooperative and Private sector, Stimulating the Mortgage Insurance Program through the use of a Closing Assistance Program to be financed with the up-front mortgage insurance premiums.

Deposits in GDB

As previously explained, the Commonwealth and its public entities have not been able to repay their loans to GDB, which has significantly affected GDB's liquidity and ability to repay its obligations.

GDB faces significant risks and uncertainties and it currently does not have sufficient liquid financial resources to meet obligations when they come due, as further described below. Recently enacted legislation has ordered the suspension of loan disbursements by GDB, imposed restrictions

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

on the withdrawal and transfer of deposits from GDB, and imposed a moratorium on debt obligations of GDB, among other measures.

As a result of the reductions in liquidity experienced subsequent to June 30, 2014, GDB took a number of liquidity enhancing and conservation measures, and explored the sale of assets and other alternatives to address its liquidity needs. In light of GDB's significant debt service obligations during fiscal year 2016, these measures, however, are not expected to be sufficient to maintain GDB's operations in the ordinary course absent the completion of a capital market transaction, a restructuring of GDB's debt, and the payment by the Commonwealth of debt service on GDB's public sector loans payable from annual appropriations. As a result of the non-payment by the Commonwealth of the appropriation to GDB and GDB's inability to restructure its debt in light of the broader fiscal crisis faced by the Commonwealth, GDB was not in a position to pay principal on its debt obligations due on May 1, 2016 and continue operations in the ordinary course. In April 2016, the Governor imposed on GDB emergency operational restrictions and debt moratorium. The GDB has continued to pay interest on its debt obligations.

Due to the conditions and events described above, GDB's management believes substantial doubt exists in the GDB's ability to continue as a going concern. The effects of GDB's inability as a going concern on the Authority's operations are uncertain. Both the Authority's and GDB's management have not evaluated the effects, thus the financial statements do not contain any adjustments that might be necessary should GDB cease to operate.

As of June 30, 2016 the Authority had the following cash and certificates of deposits in GDB:

	<u>Governmental Funds</u>	<u>Proprietary Funds</u>	<u>Total</u>
Cash	\$ 1,021,712	\$ 3,440,436	\$ 4,462,148
Certificates of deposit	<u>1,201,760</u>	<u>126,234,148</u>	<u>127,435,908</u>
	2,223,472	129,674,584	131,898,056
Less: custodial credit risk loss	—	<u>(116,506,240)</u>	<u>(116,506,240)</u>
	<u>\$ 2,223,472</u>	<u>\$ 13,168,344</u>	<u>\$ 15,391,816</u>

Management concluded that the information available prior to the issuance of the Authority's financial statements for the year ended June 30, 2016 indicates that it is probable that a custodial credit risk loss of \$116.5 million on the Authority's deposits with GDB exists as of June 30, 2016.

4. CASH AND DEPOSITS PLACED WITH BANKS

The table presented below discloses the level of custodial credit risk assumed by the Authority at June 30, 2016. Custodial credit risk is the risk that in the event of a financial institution's failure, the Authority's deposits may not be returned to it. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Funds deposited with GDB or the Economic

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

Development Bank for Puerto Rico (EDB), a component unit of the Commonwealth, are not covered by this Commonwealth requirement.

The Authority follows GDB's policies for deposits placed with banks, which establish maximum exposure limits for each institution based on the institution's capital, financial condition, and credit rating assigned by nationally recognized rating agencies. All deposits placed with banks at June 30, 2016 mature in fiscal year 2016.

As of June 30, 2016, approximately \$217.6 million of the depository bank balance of approximately \$257.7 million was uninsured and uncollateralized as follows:

	<u>Carrying amount</u>	<u>Depository bank balance</u>	<u>Amount uninsured and uncollateralized</u>
Cash	\$ 43,282,388	\$ 48,195,552	\$ 8,064,950
Deposits placed with banks	93,018,590	209,524,719	209,524,719
	<u>\$ 136,300,978</u>	<u>\$ 257,720,271</u>	<u>\$ 217,589,669</u>

Uninsured and uncollateralized cash of approximately \$8.1 million as of June 30, 2016, represents the bank balance of cash deposited at GDB. In addition, uninsured and uncollateralized deposits placed with banks includes certificates of deposit, all maturing within six months, issued by GDB and EDB amounting to approximately \$197.1 million as of June 30, 2016. Refer to Note 3 for further discussion of risks associated with GDB.

5. INVESTMENTS AND INVESTMENT CONTRACTS

The Authority follows GDB's investment policies, which provide that investment transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by Standard & Poor's or equivalent rating by Fitch Ratings or Moody's Investors Service, depending on the type and maturity of the investment and the counterparty to the transaction. Any exceptions must be approved by the Board of Directors of GDB. These investment policies also provide that purchases and sales of investment securities shall be made using the delivery versus payment method.

The following table summarizes the type and maturities of investments held by the Authority at June 30, 2016. Investments by type in any one issuer representing 5% or more of total investments of the Authority have been separately disclosed. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

This space is left intentionally blank.

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Notes to Basic Financial Statements
For the Year Ended June 30, 2016

Type of securities	Within one year	After one to five years	After five to ten years	After ten years	Total
Mortgage-backed securities:					
GNMA	\$ —	\$ —	\$ 30,424,320	\$ 67,772,461	\$ 98,196,781
FNMA	—	—	2,234,040	1,592,293	3,826,333
Other	—	—	—	178,534	178,534
Federal Home Loan Bank (FHLB)	5,223,592	19,406,782	—	—	24,630,374
Fixed-income external investment pool - Federated Government Obligations	—	—	—	5,077,432	5,077,432
Israel aid bonds	8,062,903	37,002,843	—	—	45,065,746
Nonparticipating investment contracts:					
Trinity Funding Co.	—	—	—	19,828,890	19,828,890
Citibank, N.A.	—	—	—	17,628,800	17,628,800
GDB	—	—	—	16,553,548	16,553,548
Banco Popular de Puerto Rico	—	—	—	16,445,022	16,445,022
Banco Santander de Puerto Rico	—	—	—	11,797,128	11,797,128
Total investments	\$ 13,286,495	\$ 56,409,625	\$ 32,658,360	\$ 156,874,108	259,228,588
Equity interest in Puerto Rico Community Development Fund					4,500
Total					\$ 259,233,088

At June 30, 2016 substantially all of the Authority's investments in mortgage-backed securities were held by trustees in connection with bonds issued by the Authority, the terms of which provide for early redemption of the bonds if the securities are repaid early.

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, the Authority manages its exposure to declines in fair values by diversifying the weighted average maturity date of its investment portfolio. The Authority is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment-grade core fixed-income securities.

(b) Credit Risk

Credit risk is the risk that an issuer, or other counterparty to an investment will not fulfill its obligations. The Authority's general investment policy is to apply the prudent-person rule, which establishes that investments are made, as a prudent person would be expected to act, with the discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investments. The Authority can purchase and sell notes, bonds, securities, and other debt instruments guaranteed by the Commonwealth in the short and long term with a yield rate similar to those securities with the same risk profile. These investments

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

need to be rated by the top two rating agencies and counterparties shall be rated BBB+/A-1. The Investment Grade requires ratings to be at least Baa in long-term and B in short-term securities.

All of the Authority's investments in mortgage-backed securities guaranteed by GNMA, U.S. Treasury, and Israel aid bonds carry the explicit "full faith and credit" guarantee of the U.S. government. The credit quality ratings for investments in debt securities and nonparticipating investment contracts, excluding mortgage-backed securities guaranteed by GNMA, U.S. Treasury and Israel aid bonds, as of June 30, 2016, are as follows:

Securities type	Credit risk rating					
	AAA	AA	A	BBB	B	D
Mortgage-backed securities:						
FNMA	\$ —	\$ 3,826,333	\$ —	\$ —	\$ —	\$ —
Other	—	178,534	—	—	—	—
FHLB	—	24,630,374	—	—	—	—
Fixed income external investment pool - Federated Government Obligations	5,077,432	—	—	—	—	—
Nonparticipating investment contracts:						
Trinity Funding Co.	—	19,828,890	—	—	—	—
Citibank N.A.	—	—	—	17,628,800	—	—
GDB	—	—	—	—	—	16,553,548
Banco Popular de Puerto Rico	—	—	—	—	16,445,022	—
Banco Santander de Puerto Rico	—	—	11,797,128	—	—	—
Total	\$ 5,077,432	\$ 48,464,131	\$ 11,797,128	\$ 17,628,800	\$ 16,445,022	\$ 16,553,548

The credit quality rating of nonparticipating investment contracts are based on the credit quality ratings of the counterparties with whom those contracts are entered into.

At June 30, 2016, fair value of investments based on the hierarchy of inputs are determined as follows:

	Level 1	Level 2	Level 3	Total
Mortgage Backed Securities	\$ 102,201,648	\$ -	\$ -	\$ 102,201,648
Federal Home Loan Bank	24,630,374.00	-	-	24,630,374
Federated Government Obligations	5,077,432.00	-	-	5,077,432
Israel Aid Bonds	45,065,746.00	-	-	45,065,746
Total	\$ 176,975,200	\$ -	\$ -	\$ 176,975,200

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Notes to Basic Financial Statements
For the Year Ended June 30, 2016

6. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable as of June 30, 2016, consist of the following:

Real estate loans - all types of residential property, bearing interest at various rates ranging from 5% to 18%	\$ 240,577,232
Less allowance for loan losses	<u>(34,258,583)</u>
Total	<u>\$ 206,318,649</u>

The summary of the activity in the allowance for loan losses for the year ended June 30, 2016, is as follows:

Balance - beginning of year	\$ 36,745,163
Provision for loan losses	800,000
Release of allowance	(1,966,788)
Write-offs	<u>(1,319,792)</u>
Total	<u>\$ 34,258,583</u>

On February 1, 2016 and March 3, 2016, the Authority sold certain single and multi-family mortgage loans to a financial institution and a private investor. The mortgage portfolios unpaid balance at the time of sale was approximately \$109.1 million, and the net proceeds amounted to approximately, \$89.3 million. A loss amounting to \$18.7 million was recorded as a result of these transactions. The mortgage portfolios were sold to partially repay My New Home Program line of credit in order to provide liquidity to GDB.

Real estate loans receivable represent secured loans with a first lien on the related-real estate property granted to low and moderate-income families for the acquisition of single-family units and to developers of multifamily housing units in Puerto Rico. Prior to providing mortgage financing to developers, the Authority obtains representations and approvals from appropriate Commonwealth and U.S. government agencies as to the qualifications of the prospective sponsors, as well as the financial feasibility of each project. Real estate loans are generally collectible monthly at various dates through the year 2055. The collection of noninsured/nonguaranteed real estate loans to developers is dependent on the ability of each housing project to generate sufficient funds to service its debt, which, for other than certain federally assisted housing projects, is predicated on the ability to obtain rent increases to offset increases in operating costs.

The allowance for loan losses on real estate single-family unit mortgage loans is determined considering historical loss factors of the portfolio and segmented by delinquency levels. Historical loss factors are separately calculated for each segment and applied to the outstanding loan balance

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

of the portfolio. The Authority has a policy of charging off real estate single-family unit mortgage loans that are over 60 months past due.

The following table presents the aging of the recorded investments in real estate single-family unit mortgage loans and their allowance for loan losses as of June 30, 2016:

<u>Loan aged category</u>	<u>Total loan balance</u>	<u>Allowance for loan losses</u>
Current	\$ 42,078,266	\$ 26,983
7 - 30 months	8,182,425	3,265,924
31 - 60 months	4,540,292	4,497,692
Subtotal	54,800,983	7,790,599
Other nonaged loans	7,084,916	6,974,276
Total	<u>\$ 61,885,899</u>	<u>\$ 14,764,875</u>

The allowance for loan losses on real estate multifamily housing unit mortgage loans is determined on an individual loan basis. The Authority categorizes loans into risk categories based on relevant information about the ability of the borrower to service their debt and considers specific risk indicators, financial condition of the borrower, estimated value of the collateral, and other information obtained from periodic credit review of the individual loans.

The following table presents the risk category of multifamily housing unit loans subject to risk rating and their allowance for loan losses as of June 30, 2016:

<u>Loan risk category</u>	<u>Amount</u>	<u>Allowance for loan losses</u>
Good	\$ 51,443,063	\$ 514,432
Doubtful	11,107,678	1,666,186
Loss	8,020,202	6,813,090
Total	<u>\$ 70,570,943</u>	<u>\$ 8,993,708</u>

The table presented above of multifamily housing unit loans does not include a loan of approximately \$33.2 million to a related party (refer to Note 12), which was evaluated individually and for which an allowance for loan losses was not deemed necessary.

Real estate loans receivable under the home purchase stimulus program represents subordinated second mortgage loans originated by private banking institutions under the requirements of Act. No. 9 "Puerto Rico Economic Stimulus Plan Act" and subsequently acquired by the Authority. Real estate loans originated under this program will collect principal and earn interest after the first 10 years of the term of the loan.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

The allowance for loan losses on second mortgage loans is determined considering delinquency levels of the first mortgage loans. Such delinquency levels are obtained from a participating financial institution. As of June 30, 2016, the outstanding balance of second mortgage loans was approximately \$73.7 million with an allowance for loans losses of \$10.5 million.

At June 30, 2016, the aggregate recorded investment in loans that have been restructured amounted to approximately \$14.7 million. Interest income that would have been recorded in the year if these loans had performed in accordance with their original terms would have been approximately \$1.5 million. No interest income was included in the change in net position for the year ended June 30, 2016.

7. DUE FROM FEDERAL GOVERNMENT

The Authority, as a public housing authority, is authorized to administer the U.S. Housing Act Section 8 Programs in Puerto Rico. The revenues and expenditures of such federal financial assistance are accounted for as a major governmental fund under the HUD Programs fund. Revenues and expenditures related to the administration of the U.S. Housing Act Section 8 Programs amounted to approximately \$148.3 million during the year ended June 30, 2016. This amount includes approximately \$5.1 million of administrative fees for services performed as contract administrator, which are reimbursed by HUD. As of June 30, 2016, the amounts due from federal government under the HUD Programs fund amounted to approximately \$0.9 million.

During the year ended June 30, 2016, the Authority expended approximately \$29.2 million of HOME Program funds. The Authority has approximately \$7.6 million due from the federal government as of June 30, 2016 related to the HOME Program.

The New Secure Housing Program (the NSH Program) constituted an intergovernmental effort to provide long-term hazard mitigation assistance to the Commonwealth by providing funding for relocation of eligible participants that were affected by Hurricane Georges (1998) or that lived in hazard-prone areas under the U.S. Federal Emergency Management Agency's (FEMA) Hazard Mitigation Grant Program (HMGP). Through a series of collaborative agreements, the Office of the Governor's Authorized Representative (the GAR) was named the grantee, the Puerto Rico Department of Housing (the Department of Housing) was named the subgrantee, and the Authority was named the administrator of the NSH Program.

Under the NSH Program, the Authority was responsible for project management, including contracting, supervising, and paying the designers, inspectors, and legal services needed for the NSH Program. The Authority also provided all the funding for the NSH Program through a \$67 million nonrevolving line of credit with GDB, and for land acquisitions, awarding construction contracts, qualifying participants, and selling housing units to eligible participants.

Under the terms of the grant, the construction of, and relocation of participants to new secure housing units was to be completed by December 31, 2007. In addition, FEMA would reimburse 75% of the allowable costs of the NSH Program. Funds collected under the NSH Program since its inception amounted to approximately \$113 million.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

In April 2007, FEMA discontinued reimbursing the Authority's allowable costs based on the NSH Program's noncompliance with the scheduled dates for construction activities and case management. The Department of Housing requested various extensions and reconsiderations the last one up to June 30, 2010 and FEMA granted such requests.

Although significant progress was made through June 30, 2010, in the construction activities and in the case management of the Program, the Authority was not able to fully comply with the terms of the extensions granted by FEMA. On September 30, 2011, the Authority provided FEMA and the GAR the Program's closeout documentation, which was reviewed by FEMA.

On January 30, 2012, the Authority and the Department of Housing entered into a transition agreement by which the Department of Housing would assume its obligations as the NSH Program subgrantee and project owner, including vacant property dispositions, open space monitoring, and other related matters. The Authority will continue to assume the amounts payable under the \$67 million nonrevolving line of credit with GDB, until such debt can be assumed by the Commonwealth. The Department of Housing would prospectively assume, without recourse, any additional funds that might be requested by FEMA for events of noncompliance, including related costs. The outstanding balance under the nonrevolving line of credit with GDB at June 30, 2016 was approximately \$45.8 million included as long term debt in governmental activities.

Based on all these facts and that no reimbursements have been received from FEMA since April 2007, management established an allowance for the \$26 million due from FEMA.

8. REAL ESTATE AVAILABLE FOR SALE

Real estate available for sale at June 30, 2016, consisted of the following:

Residential (1 - 4 units)	\$ 12,669,358
Valuation allowance	<u>(9,281,436)</u>
Real estate available for sale - net	\$ <u>3,387,922</u>

The following is a summary of the activity in the valuation allowance for the year ended June 30, 2016:

Balance - beginning of year	\$ 8,791,081
Provision for possible losses	691,055
Write-offs	<u>(200,700)</u>
Balance - end of year	\$ <u>9,281,436</u>

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

9. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2016, was as follows:

Governmental Activities

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets:				
Information systems	\$ 66,329	\$ —	\$ —	\$ 66,329
Office furniture and equipment	37,074	559	—	37,633
Vehicles	<u>66,135</u>	<u>—</u>	<u>—</u>	<u>66,135</u>
Total capital assets	<u>169,538</u>	<u>559</u>	<u>—</u>	<u>170,097</u>
Less accumulated depreciation and amortization for:				
Information systems	(66,307)	—	—	(66,307)
Office furniture and equipment	(35,614)	(722)	—	(36,336)
Vehicles	<u>(66,132)</u>	<u>—</u>	<u>—</u>	<u>(66,132)</u>
Total accumulated depreciation and amortization	<u>(168,053)</u>	<u>(722)</u>	<u>—</u>	<u>(168,775)</u>
Total capital assets - net	<u>\$ 1,485</u>	<u>\$ (163)</u>	<u>\$ —</u>	<u>\$ 1,322</u>

This space is left intentionally blank.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

Business-Type Activities

	<u>Beginning balance</u>	<u>Additions or Reclasses</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets:				
Land	\$ —	\$ 8,880,000	\$ —	\$ 8,880,000
Leasehold improvements	4,155,917	30,971	—	4,186,888
Information systems	4,067,509	279,824	—	4,347,333
Office furniture and equipment	2,195,377	1,225	—	2,196,602
Vehicles	<u>190,757</u>	<u>—</u>	<u>—</u>	<u>190,757</u>
Total capital assets	<u>10,609,560</u>	<u>9,192,020</u>	<u>—</u>	<u>19,801,580</u>
Less accumulated depreciation and amortization for:				
Leasehold improvements	(3,518,900)	(205,255)	—	(3,724,155)
Information systems	(3,608,887)	(344,406)	—	(3,953,293)
Office furniture and equipment	(2,154,280)	(11,691)	—	(2,165,971)
Vehicles	<u>(167,183)</u>	<u>(8,146)</u>	<u>—</u>	<u>(175,329)</u>
Total accumulated depreciation and amortization	<u>(9,449,250)</u>	<u>(569,498)</u>	<u>—</u>	<u>(10,018,748)</u>
Total capital assets - net	<u>\$ 1,160,310</u>	<u>\$ 8,622,522</u>	<u>\$ —</u>	<u>\$ 9,782,832</u>

This space left intentionally blank.

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Notes to Basic Financial Statements
For the Year Ended June 30, 2016

10. NOTES, BONDS, AND MORTGAGE-BACKED CERTIFICATES PAYABLE, AND OTHER LIABILITIES

The activity of bonds, mortgage-backed certificates, and notes payable for the year ended June 30, 2016, is as follows:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
<i>Governmental activities:</i>					
Commonwealth appropriation					
note payable - AHMSP Act No. 124	\$ 3,500,735	\$ —	\$ (103,049)	\$ 3,397,686	\$ 83,595
Less unaccredited discount	<u>(66,755)</u>	<u>2,683</u>	<u>—</u>	<u>(64,072)</u>	<u>—</u>
Subtotal	3,433,980	2,683	—	3,333,614	83,595
Notes payable to GDB:					
Investments Repurchase					
Agreement - AHMSP Act No. 124	34,192,140	953,083	(8,268,138)	26,877,085	9,370,000
Line of credit - AHMSP Act No. 124	14,557,323	933,795	—	15,491,118	—
Line of credit - My New Home Program	106,150,789	4,675,939	(84,876,052)	25,950,676	—
Line of credit - New Secure Housing Program	<u>47,700,792</u>	<u>829,745</u>	<u>(2,681,285)</u>	<u>45,849,252</u>	<u>2,393</u>
Total governmental activities	<u>\$ 206,035,024</u>	<u>\$ 7,395,245</u>	<u>\$ (95,825,475)</u>	<u>\$ 117,501,745</u>	<u>\$ 9,455,988</u>
<i>Business-type activities:</i>					
Collateralized Mortgage					
Obligation Bonds - Mortgage Trust III	\$ 97,525,002	\$ —	\$ (9,260,000)	\$ 88,265,002	\$ 25,015,000
Mortgage-Baked Certificates - 2006 Series A	75,357,112	—	(5,640,279)	69,716,833	12,259,235
Revenue bonds:					
Single Family Mortgage Revenue Bonds - Porfolio XI	<u>14,390,000</u>	<u>—</u>	<u>(590,000)</u>	<u>13,800,000</u>	<u>310,000</u>
Subtotal	187,272,114	—	(15,490,279)	171,781,835	37,584,235
Notes payable:					
Special obligation notes (Home Purchase Stimulus Program)	75,024,840	—	(1,044,167)	73,980,673	—
Plus unamortized premium	295,000	—	(19,669)	275,331	—
Less unaccredited discount	<u>(48,679,684)</u>	<u>—</u>	<u>9,449,606</u>	<u>(39,230,078)</u>	<u>—</u>
Total business-type activities	<u>\$ 213,912,270</u>	<u>\$ —</u>	<u>\$ (7,104,509)</u>	<u>\$ 206,807,761</u>	<u>\$ 37,584,235</u>

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

The annual debt service requirements to maturity, including principal and interest, for long-term debt, business-type activities, as of June 30, 2016, are as follows:

<u>Year(s) ending June 30,</u>	<u>Governmental activities</u>		<u>Business-type activities</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2017	\$ 83,595	\$ 190,022	\$ 37,584,235	\$ 3,743,053
2018	86,478	186,839	23,166,638	3,292,986
2019	89,716	183,308	32,108,277	2,951,298
2020	93,308	179,483	26,036,726	3,194,333
2021	97,171	175,315	10,149,937	4,192,009
2022-2026	500,710	811,187	6,829,075	5,008,033
2027-2031	2,446,708	358,683	35,322,248	29,703,275
2032-2036	—	—	22,148,956	21,398,452
2037-2041	—	—	19,774,545	11,805,908
2042-2046	—	—	29,619,128	6,094,994
2047-2051	—	—	3,022,743	105,411
Total	<u>\$ 3,397,686</u>	<u>\$ 2,084,837</u>	<u>\$ 245,762,508</u>	<u>\$ 91,489,752</u>

Governmental Activities

Note Payable to Puerto Rico Public Finance Corporation – On December 27, 2001, the Authority entered into a loan agreement (the Note) with the GDB to refinance the AHMSP Stage 7 note payable of the Puerto Rico Housing Bank, as authorized by Act No. 164 of December 17, 2001. The Puerto Rico Public Finance Corporation (PFC), a component unit of GDB, acquired and restructured the Note through the issuance of its Commonwealth Appropriations Bonds (the PFC Bonds). The PFC Bonds were issued under a trust indenture whereby the PFC pledged and sold the Note, along with other notes under Act No. 164, to certain trustees and created a first lien on the revenues of the notes sold. The notes payable to the PFC were originally composed of a loan granted by GDB, which, pursuant to Act No. 164 of December 17, 2001, the PFC acquired and restructured through the issuance of Commonwealth appropriation bonds. These bonds were issued under trust indenture agreements whereby the PFC pledged the notes to certain trustees and created a first lien on the pledged revenue (consisting of annual Commonwealth appropriations earmarked to repay these notes) for the benefit of the bondholders.

In June 2004, the PFC issued PFC 2004 Series A and B bonds and advance refunded a portion of certain of its outstanding Commonwealth Appropriation Bonds issued in 2001 under Act No. 164 of December 17, 2001. The Authority recognized a mirror effect of this advance refunding by the PFC in its own notes payable in proportion to the portion of the Authority's note payable included in the PFC refunding. The aggregate debt service requirements of the refunded and underfunded notes will be funded with annual appropriations from the Commonwealth.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

During the fiscal year ended June 30, 2012, the PFC issued PFC 2011 Series A and B and PFC 2012 Series A bonds, and refunded a portion of certain of its outstanding Commonwealth Appropriation Bonds issued in 2004 under Act No. 164 of December 17, 2001, including \$3.1 million of the Note. The Authority recognized a mirror effect of these current refunding's by the PFC in its own notes payable in proportion to the portion of the Authority's note payable included in the PFC refunding's.

The Note's outstanding principal balance at June 30, 2016, was approximately \$3.4 million and matures throughout August 1, 2031. Interest on the unpaid principal amount of the Note is equal to the applicable percentage of the aggregate interest payable on the PFC Bonds. The applicable percentage is the percentage representing the proportion of the amount paid by the PFC on the PFC Bonds serviced by the Note to the aggregate amount paid by the PFC on all the PFC Bonds issued by the PFC under Act No. 164, which was 6% at June 30, 2016.

Investment Repurchase Agreement – AHMSP Act No 124 – On August 8, 2014, the Authority and GDB modified the terms of the Investment Repurchase Agreement (the Agreement) extending its maturity date until July 1, 2018. The Agreement, among other things, establishes a 3% interest rate, which will be revised annually and will be based on the average cost of funds of GDB plus 0.25% basis points. The outstanding balance under this agreement was approximately \$26.9 million at June 30, 2016.

Line of Credit - AHMSP Act No 124 – On June 3, 2011, the Authority entered into an agreement with GDB to establish a line of credit to provide for the payment of subsidies under the AHMSP. The line of credit bears interest at 7% and matures on June 30, 2018. As of June 30, 2016, the outstanding balance amounted to approximately \$15.5 million.

Line of Credit - My New Home Program Financing – On June 30, 2011, the Authority entered into an agreement with GDB to establish a line of credit facility of approximately \$64 million. The financing was provided under the provisions of Act No. 122 of August 6, 2010 (Act No. 122), *Act for the Financing of My New Home Program*. Under this program, the Authority subsidizes closing costs assistance to eligible families for the purchase of a principal residence through reimbursements of origination and closing costs up to 5% of the selling price of the residence. The line of credit consisted of \$40 million to collect moneys advanced by the Authority's Operating and Administrative fund to this Program, \$20 million to continue the financing of the Program, and \$4 million to establish a reserve for the payment of interest and other financing expenses. As a source of repayment, Act No. 122 assigned to the Authority, for a period of seven years, a portion of no less than 80% of the unreserved moneys and other liquid funds abandoned or unclaimed in financial institutions of Puerto Rico that will be transferred to the general fund of the Commonwealth. Act No. 42 of February 14, 2012 amended Act No. 122 increasing the portion of unreserved monies and other liquid funds abandoned or unclaimed to 85% and 100% once the claims for any pending debt related to tax credit are paid. In addition, Act No. 42 eliminates the seven-year limit and establishes the funding in perpetual form. The funding entered into effect in September 2014. The Program to subsidize closing costs assistance concluded in February 2013, and no additional subsidies are expected to be provided by the Authority under this Program. As of June 30, 2016, the Authority's cumulative drawdowns amounted to approximately

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

\$106.2 million. Using the proceeds from the sale of certain single and multi-family mortgage loans, the Authority repaid \$80.2 million of the line of credit. Accordingly, the outstanding balance of the line of credit as of June 30, 2016 amounts to \$26 million.

Line of Credit – New Secure Housing Program Financing – This line of credit was used originally to provide resources used to provide benefits to participants qualifying under the provisions of Act No. 92 of August 4, 2001 (Act No. 92), *Act for the Financing of My New Secure Home Program*. Under this program, the Authority makes possible to families or individuals that live in flood-prone or high risk areas, to acquire secure and low cost homes. The line bears interests at a 3-months LIBOR with a differential up to 1.25% or the prevailing interest negotiated by the President of the GDB, and is due on June 30, 2027. The line is payable 75% from funds granted by FEMA and 25% provided by the Commonwealth, which could be achieved through the donation of land, and the mortgages of the eligible participants of the program. In case that the repayments funds are not received, the Authority will pay the line of credit with future legislative appropriations to be provided by the Commonwealth. As of June 30, 2016, the line of credit balance is \$45.8 million.

Business-Type Activities

Bonds, notes, and mortgage-backed certificates payable by business-type activities, consist of the following:

<u>Description and Maturity date</u>	<u>Interest rate</u>	<u>Amount outstanding</u>
Collateralized Mortgage Obligation bonds - Mortgage Trust: III Each July 1 and January 1 until January 1, 2021	Zero Coupon	\$ 76,789,813
Single Family Mortgage Revenue Bonds - Portfolio XI - Each December 1 and June 1 until December 1, 2039	3.46% - 5.45%	13,800,000
Mortgage-Backed Certificates, 2006 Series A - principal and interest payable monthly from September 29, 2006 to August 29, 2030	2.955% - 6.56%	64,456,195
Special Obligation Notes, 2010 series A and B - Principal and interest payable monthly from July 1, 2019 to May 1, 2040	6.95% - 6.974%	20,926,300
Special Obligation Notes, 2011 Series A - Principal and interest payable monthly from September 1, 2021 to September 1, 2041	7.00%	11,753,778
Special Obligation Notes, 2012 Series A - Principal and interest payable monthly from June 18, 2012 to September 1, 2041	7.00%	<u>19,081,675</u>
Total, net of unamortized premiums and discounts		<u>\$ 206,807,761</u>

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

Compensated Absences – The activity for compensated absences, included within accounts payable and accrued liabilities of the operational and administrative fund, during the year ended June 30, 2016, is as follows:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Vacation	\$ 712,291	\$ 787,159	\$ (834,365)	\$ 665,085	\$ 665,085
Sick leave	711,018	471,100	(336,178)	845,940	845,940
Total	<u>\$ 1,423,309</u>	<u>\$ 1,258,259</u>	<u>\$ (1,170,543)</u>	<u>\$ 1,511,025</u>	<u>\$ 1,511,025</u>

Compensated absences are available to be liquidated by the employees during the year from monies of the operational and administrative fund.

11. MORTGAGE LOANS INSURANCE PROGRAM

The mortgage loans insurance program was created by Act No. 87 of June 25, 1965, as amended, to provide mortgage credit insurance to low and moderate-income families on loans originated by the Authority and other financial institutions. This activity can be increased through legislative appropriations, if and when needed, and derives its revenue from premiums charged to the borrowers, interest on investments, and sales of properties acquired through foreclosure. The Authority manages the risk of loss of its mortgage loans insurance activities by providing its insurance program only to financial institutions that (1) maintain certain defined minimum capital, (2) are qualified based on experience and resources, (3) perform certain collection efforts, and (4) comply with established procedures and requirements. In addition, the Authority requires certain loan-to-value ratios on loans insured and inscription of the collateral in the property registry of the Commonwealth. The activities of this program are included in the proprietary fund.

Additionally, the Authority created the Puerto Rico Housing Administration Program, expanding requirements and parameters under the existing Act No. 87. The Program allows citizens, paying an annual insurance premium, to originate mortgage loans with up to a 98% loan to value ratio. The Program insures participating lending institutions in events of foreclosure. The Program is financed through annual insurance premiums, commitment and transaction fees, and proceeds from any sale of foreclosed real estate. This Program also requires participants to comply with various eligibility requirements.

The Commonwealth guarantees up to \$75 million of the principal insured by the Program. As of June 30, 2016, the Program covered loans aggregating to approximately \$576 million. An allowance of \$7.1 million was recorded as of June 30, 2016 as an estimate of the losses inherent in the portfolio.

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Notes to Basic Financial Statements
For the Year Ended June 30, 2016

The mortgage insurance loan total premium and investment income for the year ended on June 30, 2016 is as follows:

Mortgage loans insurance premiums	\$ 4,392,244
Investment income	<u>796,496</u>
Total	<u>\$ 5,188,740</u>

The regulations adopted by the Authority, requires the establishment of adequate reserves to guarantee the solvency of the mortgage loans insurance fund. At June 30, 2016, the Authority had restricted net position for such purposes of approximately \$77.4 million.

12. RELATED-PARTY TRANSACTIONS

A summary of the most significant related-party balances and transactions as of June 30, 2016, and for the year ended is as follows:

(a) Commonwealth

Legislative appropriations of approximately \$5.7 million were received by the governmental funds during the year ended June 30, 2016. These appropriations are restricted for the payment of certain bonds and to support affordable housing programs.

During the year ended June 30, 2016, the Authority paid \$336,673 to the Commonwealth pursuant to the requirements of Law Number 66 of June 17, 2014, *Special Law for Fiscal and Operational Sustainability of the Commonwealth of Puerto Rico*, (Law 66). According to the provisions of Law 66, Article 19, the Authority must transfer a contribution determined under certain parameters required by Law 66.

This space is left intentionally blank.

Puerto Rico Housing Finance Authority
(A Component Unit of the Government Development Bank for Puerto Rico)
Notes to Basic Financial Statements
For the Year Ended June 30, 2016

(b) GDB

The Authority has the following additional related-party balances and transactions with GDB as of and for the year ended June 30, 2016:

	<u>Carrying amount</u>	<u>Interest rate</u>	<u>Interest income (expense)</u>
Assets:			
Cash - including accrued interest	\$ 4,462,217	Variable	\$ 10,499
Deposits place with banks - including accrued interest	127,435,908	0.75% - 1.60%	1,032,453
Nonparticipating investment contracts - including accrued interest	<u>16,625,627</u>	5.25%	<u>854,396</u>
Total assets	<u>\$ 148,523,752</u>		<u>\$ 1,897,348</u>
Liabilities:			
Repurchase Agreement - including accrued interest	\$ 26,877,085	3.00%	\$ (3,108,582)
Lines of credit and notes payable - including accrued interest	<u>82,975,263</u>	1.52% - 7.00%	<u>(2,155,499)</u>
Total liabilities	<u>\$ 109,852,348</u>		<u>\$ (5,264,081)</u>
Expenses - administrative charges	<u>\$ 852,300</u>		

Department of Housing – At June 30, 2016, the Authority has an amount due from the Puerto Rico Department of Housing (Department of Housing) amounting to \$581,687. Management has fully reserved this balance as of June 30, 2016.

The Authority entered into a 30-year lease agreement with the Department of Housing to rent office space expiring in 2037. During the term of the lease, the Authority will pay an annual rent of \$1.5 million. The agreed-upon rent includes parking spaces, maintenance, and security services in common areas. The Department of Housing will be responsible for the payment of utilities in exchange for an additional payment of \$350,000 payable in a lump sum on or before August 31 of each year. Rent expense during the year ended June 30, 2016, amounted to \$1.5 million.

Investment in Puerto Rico Community Development Fund, LLC – Puerto Rico Community Development Fund, LLC (PRCDF), an entity organized under the laws of Delaware, is a Community Development Entity (CDE). PRCDF has two members, the Authority (50%) and the Department of Housing (50%). On November 30, 2009, PRCDF was allocated \$45,000,000 of New Markets Tax Credits for investments in, or loans to, Qualified Active Low-Income Community Businesses (QALICB's) whose principal activities involve the development or rehabilitation of real estate. In October 2011 and in February 2012, PRCDF transferred \$13,500,000 and \$31,500,000,

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

respectively, of its allocation to PRCDF I, LLC (PRCDF I). PRCDF I, an entity organized under the laws of Delaware, is also a CDE. PRCDF I has one managing member, PRCDF (0.01%) and one investor member, PRHFA RLF Investment Fund, LLC (99.99%), which is wholly owned by Citi Community Capital (Citi). The managing member and the investor member have made capital contributions of \$4,500 and \$45,000,000, respectively. The capital contributions have been used to establish a loan revolving fund for loans to QALICB's.

The New Markets Tax Credit Program (NMTC Program) was established by the U.S. Congress in 2000 to spur new or increased investments into operating businesses and real estate projects located in low-income communities. The NMTC Program attracts investment capital to low-income communities by permitting individual and corporate investors to receive a tax credit against their Federal income tax return in exchange for making equity investments in specialized financial institutions called Community Development Entities. The credit totals 39% of the original investment amount and is claimed over a period of seven years (five percent for each of the first three years, and six percent for each of the remaining four years). The investment in the CDE cannot be redeemed before the end of the seven-year period.

An organization wishing to receive awards under the NMTC Program must be certified as a CDE by the Community Development Financial Institution Fund of the U.S. Department of the Treasury.

To qualify as a CDE, an organization must:

- Be a domestic corporation or partnership at the time of the certification application
- Demonstrate a primary mission of serving, or providing investment capital for low-income communities or low-income persons
- Maintain accountability to residents of low-income communities through representation on a governing board of or advisory board to the entity.

13. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Authority is a party to financial instruments with off-balance-sheet risk to meet financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and to purchase mortgage-backed securities. These instruments involve, to varying degrees, elements of credit, and interest rate risk in excess of amounts recognized in the balance sheet. The off-balance-sheet risks are managed and monitored in manners similar to those used for on-balance-sheet risks. The Authority's exposure to credit losses for lending and purchasing commitments is represented by the contractual amount of those transactions.

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since these commitments might expire

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Authority evaluates each customer's creditworthiness on a case-by-case basis.

The amount of the collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral generally includes income-producing commercial properties. At June 30, 2016, commitments to extend credit amounted to approximately \$39 million.

Commitments to purchase mortgage-backed securities are agreements to acquire such securities at a fixed price on behalf of certain housing programs. At June 30, 2016, there were no commitments outstanding to purchase mortgage-backed securities.

14. RETIREMENT SYSTEM

Substantially all full-time employees of the Authority are covered by The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the Retirement System). The Retirement System consists of different benefit structures pursuant to Act No. 447 of May 15, 1951, as amended, including a cost-sharing, multi-employer, defined benefit program and a cash balance program, similar to a cash balance plan. The Retirement System is sponsored by the Commonwealth and the Authority.

On July 6, 2011, the Commonwealth enacted Act No. 116 increasing the employer contribution rate from 9.275% to 10.275% of employee compensation for the 2011-2012 fiscal year, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020.

On April 4, 2014, the Commonwealth enacted Act No. 3 to increase the employee contribution rate from 8.275% to 10% effective July 1, 2014.

Total employee contributions to the Retirement System, including System 2000, for the year ended June 30, 2016, amounted to approximately \$653,000 and \$870,000, respectively. The Authority's contributions for the years ended June 30, 2016, 2015, and 2014, amounted to approximately \$1.7 million, \$1.1 million, and \$1.2 million, respectively. These amounts represented 100% of the required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the Retirement System itself.

The actuarial valuation of the Basic System Benefits and System Administered Benefits as of June 30, 2014 (most recently available) reflects a fiduciary net position of \$127 million, total pension liability of \$30.2 billion and a net pension liability of \$30.1 billion.

Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* (GASB 68) became effective for the year ended June 30, 2015. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

pension plans administered as trusts or equivalent arrangements that meet certain criteria as is the case of the ERS.

As of the date of the release of this report, the ERS has not issued its 2015 basic financial statements, nor has it provided the Authority with the required information to implement the requirements of GASB 68. Therefore, the accompanying financial statements do not have any adjustments that will be necessary for the Authority to account for its proportionate share of the net pension liability, deferred inflow of resources and deferred outflow of resources in the statement of net position and in the balance sheet of the proprietary fund as of July 1, 2015 and June 30, 2016, as well as the effect in the recorded pension expense in the statement of activities and the statement of revenues, expenses and changes in net position of the proprietary fund for the year ended June 30, 2016. Also, additional disclosures required by GASB 68 as well as required supplementary information have been omitted from these basic financial statements.

Additional information on the Retirement System is provided in its standalone financial statements, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico, P.O. Box 42004, San Juan PR 00940-2004.

15. EARLY RETIREMENT PROGRAMS

On October 13, 2010, the Authority announced to its employees a voluntary termination plan (the Plan) based on Act No. 70 enacted on July 2, 2010. The Plan was approved by the Authority's board of directors on October 6, 2010. Act No. 70 provides that eligible employees may retire from employment from the Commonwealth in exchange for an early pension, an economic incentive, and other benefits.

The Plan only applied to employees who were 10 years or less from retirement in accordance with their applicable retirement plans as of December 1, 2010. The Plan approved by the Authority's board of directors provides the following:

The employee will receive an annuity of fifty percent of the salary in effect at September 30, 2010. The Authority is responsible for the payment of the annuity in addition to the related employee and employer contributions to Retirement Systems for a maximum period of 10 years.

The employee will receive an economic incentive of six month's salary. This incentive is exempt from income taxes as established by Act No. 70. The employee will receive the benefits of health and dental insurance for a period of one year.

The total amount of employees that were voluntarily separated from employment as of June 30, 2016 was six. Employee and employer contributions to the Retirement System and the employee annuity for the applicable period were discounted based on the average interest rate of unpledged investments. As of June 30, 2016, the total liability related to this plan was approximately \$464,000 and is included in accounts payable and accrued liabilities of business-type activities.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

16. COMMITMENTS AND CONTINGENCIES

Other Risks Related to Mortgage Loans Servicing and Insurance Activities – Certain loan portfolios of the Authority are administered by private servicers who are required to maintain an errors and omissions insurance policy. The Authority has a program to manage the risk of loss on its mortgage loan lending and insurance activities.

Custodial Activities of Proprietary Fund – At June 30, 2016, the Authority was custodian of \$256,033 in restricted funds of former “*Corporación de Renovación Urbana y Vivienda*” (CRUV). As of June 30, 2016, such funds were deposited with GDB. These funds are not owned by the Authority’s proprietary fund and, thus, are not reflected in the basic financial statements.

Loan Sales and Securitization Activities – On July 13, 1992, the Authority entered into an agreement to securitize approximately \$20.7 million of mortgage loans into a FNMA certificate. The Authority agreed to repurchase, at a price of par plus accrued interest, each and every mortgage loan backing up such security certificate that became delinquent for 120 days or more. As of June 30, 2016, the aggregate outstanding principal balance of the loans pooled into the FNMA certificate amounted to \$218,830.

Mortgage Loan Servicing Activities – The Authority acts as servicer for a number of mortgage loans owned by other investors. The servicing is generally subcontracted to a third party. As of June 30, 2016, the principal balance of the mortgage loans serviced for others is as follows:

<u>Investor</u>	<u>Amount</u>
PRCDF I	\$ 29,301,500
CRUV or its successor without guaranteed mortgage loan payments	<u>19,113</u>
Total	<u>\$ 29,320,613</u>

Litigation – The Authority is a defendant in several lawsuits arising out of the normal course of business. Management, based on discussion with legal counsel, is of the opinion that the ultimate liability, if any, resulting from these pending proceedings will not have a material effect on the financial position or results of operations of the Authority. A liability to cover litigation claims and contingencies amounting to \$15,000 has been included as part of accounts payable and accrued liabilities in the accompanying statement of net position.

HOME Program – The U.S. Office of Inspector General (OIG) performed various examinations of the HOME Program covering fiscal years ended prior to July 1, 2010. These examinations covered periods in which the HOME Program was under the administration of the Department of Housing. These examinations identified instances of noncompliance with terms and conditions of the grant agreements, applicable federal law, and the HOME Program’s regulations, including but not limited to the expenditure of resources for ineligible purposes. OIG identified in its examinations disallowed costs, amounting to approximately \$18.3 million. The Authority recorded a contingency for such disallowed costs, and additional amounts identified internally as potential

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

disallowances, amounting to approximately \$20.4 million. On October 1, 2013, the Authority entered into a three-year repayment plan through February 1, 2016 to reimburse the HOME Program, beginning on October 15, 2013, approximately \$1.8 million that were determined to be disallowed costs within the \$18.3 million discussed above.

On July 31, 2014, the Governor of the Commonwealth signed the HOME Voluntary Repayment Settlement Agreement (the Agreement) with HUD. The Agreement establishes the reimbursement to the HOME Program of an additional \$14.2 million, from nonfederal funds, for disallowed expenditures in connection with HUD-funded projects, as defined and described in the Agreement, in two installments of \$10 million and \$4.2 million due on October 1, 2014 and October 1, 2015, respectively. The payments were made on such dates in accordance with the Agreement.

Other federal programs are also subject to audits. Such audits could result in claims against the resources of the Authority. No provision has been made for any liabilities that may arise from such audits since the amount, if any, cannot be determined at this date.

17. CONDUIT DEBT AND PROGRAMS SPONSORED BY THE AUTHORITY

In December 2003, the Authority issued \$663 million in Capital Fund Program Bonds Series 2003 to lend the proceeds thereof to the Public Housing Administration (PHA), a governmental instrumentality of the Commonwealth. PHA utilized such funds for improvements to various public housing projects in the Commonwealth. The Capital Fund Program Bonds Series 2003 are limited obligations of the Authority, which will be paid solely from an annual allocation of public housing capital funds when received from the U.S. Department of Housing and Urban Development and other funds available under the bonds indenture. Accordingly, these bonds are considered no-commitment debt and are not presented in the accompanying basic financial statements. The outstanding balance of these bonds amounted to approximately \$129.3 million at June 30, 2016.

On August 1, 2008, the Authority issued the Capital Fund Modernization Subordinate Bonds amounting to approximately \$384.5 million. The proceeds from the issuance were used to finance a loan to a limited liability company (the LLC) and pay the costs of issuance. The \$384.5 million bonds are limited obligations of the Authority, payable primarily by a pledge and assignment of federal housing assistance payments made available by HUD with an outstanding balance of approximately \$285.0 million at June 30, 2016.

18. INTERFUND BALANCES AND TRANSFERS

The summary of the interfund balances as of June 30, 2016, between the governmental funds and the proprietary fund is as follows:

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

<u>Receivable by</u>	<u>Payable by</u>	<u>Purpose</u>	<u>Amount</u>
Proprietary fund:	Governmental funds:		
Operating and Administrative	HOME Programs	Reimbursement of expenditures	\$ 963,140
Operating and Administrative	HUD Programs	Reimbursement of expenditures	1,420,378
Operating and Administrative	AHS Programs	Reimbursement of expenditures	<u>20,888,641</u>
Total			<u>\$ 23,272,159</u>

The summary of the interfund transfers for the year ended June 30, 2016, is as follows:

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
Proprietary fund:	Governmental funds:		
Operating and Administrative	AHS Programs	Payment of debt	<u>\$ 96,856,805</u>
			<u>\$ 96,856,805</u>

19. SUBSEQUENT EVENTS

The Authority evaluated subsequent events until April 10, 2017, the date the financial statements were available to be issued.

The Puerto Rico Oversight, Management, and Economic Stability Act, Pub. Law 114-187 (PROMESA), was enacted into federal law on June 30, 2016, one day before the Commonwealth was expected to, and did, default on substantial payment obligations. PROMESA includes a variety of provisions applicable to Puerto Rico, its instrumentalities and their liabilities and operations. The following is a summary of PROMESA, which is intended as a broad overview of primary provisions of PROMESA:

Oversight Board: PROMESA establishes a seven-member Oversight Board, the members of which have been designated by Congress and the President. The Oversight Board is provided with broad authority over Puerto Rico and instrumentalities of Puerto Rico which the Oversight Board designates as “covered” instrumentalities. The Oversight Board is an autonomous body that has broad authority and discretion over Puerto Rico, including the ability to place Puerto Rico itself and a “covered” instrumentality into a debt restructuring proceeding established under PROMESA, require and approve a fiscal plan, require and approve a budget, oversee operations and implement changes that are necessary to comply with an approved fiscal plan or budget, approve the issuance of debt, hold hearings and issue subpoenas in furtherance of its functions, enter into its own contracts, analyze a territory’s pensions and pension liability, approve voluntary settlements with creditors, and become a direct party in litigation against Puerto Rico or an instrumentality. The Oversight Board is, in effect, considered a division of the territory and can hire officers, professionals and legal counsel.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

Fiscal Plans and Budgets: A critical component of PROMESA is the requirement of Puerto Rico and covered instrumentalities to develop and maintain a fiscal plan. A fiscal plan for the territory, or any instrumentality designated by the Oversight Board generally must contain numerous provisions governing the operation of the territory or instrumentality, as the case may be, including plans to pay debts, eliminate deficits, maintain essential public services and impose internal controls for fiscal governance and accountability. Each fiscal plan is also required to set forth methods for the territory or instrumentality to access the capital markets. The fiscal plan must be developed by the governor, with oversight by the Oversight Board, and submitted to the Oversight Board for approval (the Oversight Board can submit its own fiscal plan if the governor's fiscal plan is not acceptable in the sole discretion of the Oversight Board).

A fiscal plan is also required to comply with Puerto Rico law and to maintain valid liens. PROMESA further specifies that no budget can be submitted by the territory's governor to its legislature unless the Oversight Board has approved a fiscal plan and the budget is consistent with the fiscal plan (and, similar to fiscal plans, the Oversight Board can submit its own budget if the governor's budget is not acceptable in the sole discretion of the Oversight Board).

Automatic Stay: Upon the enactment of PROMESA, effective July 1, 2016 a temporary stay or statutory injunction went into effect under Title IV thereof which stays, among other things, all actions and litigation against Puerto Rico and its instrumentalities to collect or enforce liabilities or claims and actions to possess or control their property. The stay has certain very limited exceptions, but generally all enforcement actions against Puerto Rico and its instrumentalities, or other actions to control their property, are stayed through the temporary stay period.

The stay would continue in effect until May 2017 unless it was temporarily extended by the Oversight Board for seventy-five (75) days or by a federal district court for sixty (60) days. On January 28, 2017, the Oversight Board extended the stay to May 1, 2017. The stay goes into effect regardless of whether Puerto Rico or an instrumentality is subject to debt restructuring provisions discussed below. However, if Puerto Rico or an instrumentality becomes subject to the Act's debt restructuring provisions, then such restructuring provisions will impose an automatic stay during the restructuring proceedings which is substantially similar to the automatic stay under the Bankruptcy Code.

PROMESA specifies that actions taken in violation of the stay are voidable. Relief from the temporary stay may be granted "for cause". The stay is designed to enable Puerto Rico and its instrumentalities to, among other things, assess their respective finances and negotiate potential resolutions with creditors. The stay under Title IV does not have any exceptions to such stay for pledged "special revenues" or any "safe harbors" to terminate and liquidate financial contracts such as repurchase agreements, swaps or securities contracts.

The terms of the stay also preclude parties from exercising remedies, or terminating or modifying contracts, during the term of such stay if the event giving rise to the remedy is nonpayment of principal or interest or the debtor's financial condition or insolvency, notwithstanding what is provided for in the related agreement.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

The stay also precludes enforcement of defaults under separate contracts, such as defaults under repurchase agreements, guaranteed investment contracts or similar agreements with bond trustees, that would otherwise occur based on the financial condition or insolvency of Puerto Rico or an instrumentality. Thus, bonds issued by Puerto Rico or its instrumentalities that are secured by special revenues are stayed during this period and parties to financial contracts such as repurchase agreements, swaps or securities contracts (whether with Puerto Rico or an instrumentality as a party, or which would be triggered by the financial condition of Puerto Rico or an instrumentality) are precluded from terminating and liquidating such contracts during this stay.

PROMESA permits Puerto Rico and its instrumentalities to voluntarily pay liabilities during the period of the stay. Thus, Puerto Rico and its instrumentalities can elect to, but are not required to, make payments on debts or other obligations during the stay period.

Debt Adjustment: Title III of PROMESA creates its own provisions under which Puerto Rico itself or an instrumentality selected by the Oversight Board can file a case to reorganize its debts in a plan of adjustment. It incorporates by reference numerous provisions of the Bankruptcy Code, including many from Chapter 9 (which governs bankruptcy proceedings of a municipality under the Bankruptcy Code).

Based on the incorporation of numerous Bankruptcy Code provisions into PROMESA, a debt adjustment proceeding of Puerto Rico or a covered instrumentality under Title III of PROMESA would also include (like a reorganization proceeding of a municipal debtor under Chapter 9 of the Bankruptcy Code) (i) the imposition of an automatic stay, (ii) the ability of a debtor to generally govern its operations and engage in post-petition financing and (iii) the ability of the debtor to exercise avoidance powers.

The provisions from the Bankruptcy Code that are incorporated into PROMESA include, among other things, many definitions, Sections 902, 922 and 928, which generally govern pledged “special revenues” and their treatment in a Chapter 9 bankruptcy commenced by a municipality, and Section 926, which generally exempts a municipal debtor's payments on its bonds or notes from constituting an avoidable preference.

The special revenue provisions in Sections 902, 922 and 928 of the Bankruptcy Code would, in the Bankruptcy Code context, specify that special revenues pledged to secure a municipal debtor's bonds can continue to be transferred in a manner consistent with the Bankruptcy Code notwithstanding the automatic stay.

In addition to incorporating the Bankruptcy Code's Chapter 9 “special revenue” provisions, it incorporates the Bankruptcy Code's “safe harbors” for certain financial contracts to which the municipal debtor is a party. The safe harbors for specified financial contracts would, generally speaking, permit the exercise of a contractual right to terminate and liquidate the contract based on the debt adjustment proceeding, notwithstanding the automatic stay.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

The criteria under PROMESA for Puerto Rico or an instrumentality to be eligible to file a debt restructuring proceeding include approval by the Oversight Board and the desire of such entity to effect a plan of adjustment. The Oversight Board, in approving the filing, must certify, among other things, that the entity has engaged in good-faith efforts to enter into voluntary agreements to restructure its debts, has an approved fiscal plan and has no "qualifying modification" of its bond debt (as addressed further below based on the collective creditor action provisions of PROMESA). However, unlike the eligibility criteria for municipal debtors under the Bankruptcy Code, PROMESA does not require that an entity seeking to file a debt adjustment proceeding be insolvent. The Bankruptcy Code provisions for a federal court to confirm a Chapter 9 plan of adjustment are also generally incorporated into PROMESA, including that the plan be in the best interest of creditors (which is generally viewed in the Bankruptcy Code context as treating creditors at least as, or better than, they would be treated under non-bankruptcy alternatives to a debt restructuring proceeding).

In addition to the Bankruptcy Code confirmation standards, however, PROMESA also requires that a plan of adjustment be consistent with PROMESA and the debtor's fiscal plan. The Oversight Board would continue to govern the territory or covered instrumentality during the debt restructuring proceeding and is the only entity with the authority to submit a plan of adjustment.

The reorganization proceeding would be commenced in federal district court in Puerto Rico, and such court would oversee the proceeding under PROMESA. The plan of adjustment would be submitted by the Oversight Board to such court for confirmation. PROMESA permits a jointly administered reorganization proceeding and a joint plan of adjustment to address various affiliates (although affiliates are not substantively consolidated).

The Federal Rules of Bankruptcy Procedure would also apply in a debt adjustment proceeding under PROMESA. Collective Creditor Action to Modify Bond Terms: The collective creditor action provisions of Title VI of PROMESA are, generally speaking, a method to effectuate an overall bond restructuring of Puerto Rico or an instrumentality as a general alternative to the debt adjustment provisions under Title III discussed above.

PROMESA includes, in Title VI thereof, provisions to permit the terms of bond obligations to be modified based on the collective action of applicable bondholders, but without 100% consent of all affected bondholders. Modifications to a bond financing can be proposed by the bond issuer (Puerto Rico, or an instrumentality) or by bondholders. Generally, if modifications to bond financings of an issuer are considered, the Oversight Board, in consultation with the bond issuer, will separate similar bond claims into separate pools. Title VI of the Act provides that bonds issued by Puerto Rico or an instrumentality can be modified and become a "qualified modification" binding on all bondholders in the applicable pool of bondholders if (i) holders of at least two-thirds of the pool's principal amount who actually vote, and holders of at least fifty percent (50%) of the total principal amount outstanding in such pool vote, to approve the modification and (ii) the modification is approved by the Oversight Board. If less than one hundred percent (100%) of the related pool of bond obligations does not approve the proposed modification, the modification will not become effective and binding on such holders until a federal district court has approved the modification.

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

The collective creditor action provisions appear designed to permit resolution of all bond obligations of Puerto Rico or an instrumentality as bond issuer based generally on negotiated and voluntary agreements with a requisite percentage of bond claims in all related pools. These provisions, which permit modification of bond terms without one hundred percent (100%) holder consent, do not appear to have precedent in municipal bond law. These provisions also operate outside of traditional confirmation standards for a plan of adjustment (such as the “best interest of creditors” test), which could otherwise provide some protection to minority bondholders. Although these provisions appear designed to provide for a resolution of bond claims generally against a particular issuer, it is unclear how such provisions would be applied, especially if presented to a court for approval. Additional Provisions: It addresses several other economic initiatives, including (i) infrastructure revitalization, (ii) appointment of a revitalization coordinator under the authority of the Oversight Board and (iii) provisions permitting Puerto Rico to temporarily lower the minimum wage of younger workers.

On October 16, 2016, the Puerto Rico Department of Treasury issued Circular Letter 1300-08-17 whereby it is declaring that Bank’s management understand that there is a substantial doubt as to the Bank’s ability to continue as a going concern. Further, the Circular Letter requires the Corporations and Municipalities to perform an impairment analysis of its deposits on the Bank, in which the unrealizable deposits need to be accounted as a custodial credit risk loss.

On January 29, 2017, the Governor signed Act No. 5 of 2017 (Act 5), Puerto Rico Financial Emergency and Fiscal Responsibility Act, superseding and amending Act 21. The Act 5 is intended to facilitate and encourage a voluntary negotiation process under PROMESA between the Governor and/or the Puerto Rico Fiscal Agent and Financial Advisory Authority, on behalf of the Government of Puerto Rico, and the creditors of the Government of Puerto Rico and its instrumentalities. The Act 5 authorizes the Government of Puerto Rico, within the parameters established by PROMESA, to designate certain services necessary for the health, safety and welfare of the residents of Puerto Rico and provided by the Government of Puerto Rico and its instrumentalities as “essential services”, in accordance with the Constitution of Puerto Rico.

Based on the Act 5, an emergency period commencing on the effective date of the Act and ending upon May 1, 2017, which term may be extended by the Governor pursuant to an executive order for one additional period of three (3) months, was declared. Section 203 of the Act 5 provides, among other, that, during the emergency period:

- the Governor shall pay debt service to the extent (a) possible after all essential services of the Commonwealth of Puerto Rico have been provided for; or (b) ordered to do so by the Oversight Board or any other board created under federal law. In the event that the provisions of the Act 5 are in conflict with the provisions of any other law, the provisions of this Act 5 shall prevail.
- the Governor may issue executive orders requiring the use of available resources to be deposited in a lockbox account under the sole control of the Puerto Rico Fiscal Agent and Financial Advisory Authority to pay for essential services as the Governor deems necessary to protect the health, safety, and welfare of the residents of Puerto Rico. The Governor may take any and all actions that the Governor deems reasonable and necessary to preserve the ability of

Puerto Rico Housing Finance Authority

(A Component Unit of the Government Development Bank for Puerto Rico)

Notes to Basic Financial Statements

For the Year Ended June 30, 2016

the Commonwealth or an instrumentality of the Commonwealth to continue providing essential services to residents of Puerto Rico.

- the Governor may issue executive orders establishing priority rules for the disbursement of public funds when resources available for a fiscal year are insufficient to cover the appropriations made for that fiscal year.
- notwithstanding Section 4(c) of Act No. 147 of June 18, 1980, as amended, the Governor may reprioritize certain services and expenses to a higher payment priority.
- the Governor may issue executive orders as the Governor deems necessary or advisable to assure the payment of a debt obligation of the Commonwealth or an instrumentality of the Commonwealth.

On October 14, 2016, on March 9, 2017 and again on March 13, 2017, the Commonwealth submitted a fiscal plan for the review and approval of the Oversight Board which includes, among other things, the following aspects for financial and operational recovery:

- Minimization of Impact of Austerity on Economic Growth
- Improving Budgetary Controls and Financial Transparency
- Rationalization of Expenditures and Tax Policy to Promote Efficiency
- Enacting Structural Economic Measures and Investing in Growth
- Protection of Vulnerable Stakeholders
- Creation of a Sustainable Debt Level That Allows for Economic Growth
- Partner with the Federal Government to Generate Growth

On March 13, 2017, the Oversight Board conditionally approved the fiscal plan presented by the Governor.

