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<u>BY ELECTRONIC MAIL</u>

December 10, 2025

Mr. Francisco J. Domenech Fernández
Executive Director
Fiscal Agency and Financial Advisory Authority

Dear Mr. Domenech Fernández:

The Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") is in receipt of a letter and supporting documentation (the "Supporting Materials") from the Fiscal Agency and Financial Advisory Authority ("AAFAF", for its Spanish acronym), dated September 22, 2025, which request the Oversight Board's review and approval for the proposed debt transaction described in Appendix A (the "Proposed Debt Transaction").

We appreciate your submission of the Proposed Debt Transaction and the representations made by AAFAF and the Puerto Rico Housing Finance Authority (the "HFA") via various written Requests for Information ("RFI") and a virtual meeting, prior to the execution of the same.

Pursuant to Section 207 of the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), the Financial Oversight and Management Board for Puerto Rico must approve debt transactions involving the Government of Puerto Rico or its instrumentalities. The Oversight Board has reviewed the Proposed Debt Transaction and has determined that the Proposed Debt Transaction **Requires Further Review.**

The HFA has a variety of programs to promote affordable housing in Puerto Rico. Many of these leverage federal funds and federal tax credits, such as Community Development Block Grant—Disaster Recovery ("CDBG-DR") and Low-Income Housing Tax Credits ("LIHTC"). Under the responsibilities of PROMESA Section 207, the Oversight Board has assessed and approved HFA proposed transactions, including $1.4B across 19 projects to build or rehabilitate 3,139 units of affordable housing.

We appreciate HFA's mission 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.

Although the Proposed Debt Transaction complies with CDBG-DR and LIHTC program standards and with U.S. Housing and Urban Development ("HUD") guidelines, the project's economics as presented raise questions regarding the long-term feasibility of the project, the long-term impact it will have on Puerto Rico, and the government's strategy to ensure the utilization of federal funds is maximized to increase the availability of affordable housing in Puerto Rico and to support residents with the greatest need. Considering the information and responses received, the Oversight Board **has additional concerns** regarding the Proposed Debt Transaction pursuant to Section 207 of PROMESA, as detailed below.

Specific Observations and Areas of Concern Requiring Explanation

The Oversight Board would like to understand the level of oversight and diligence performed by HFA, Puerto Rico Department of Housing ("DOH"), and AAFAF given the observations below:

1. **High unit costs compared to peers:** The total estimated cost of the 138-unit Apolonia Apartments project is $101.6M, fully funded through a combination of $79.6M of CDBG-DR funds and the monetization of $22.0M of LIHTC. This equates to a total cost per unit for the project of $736k when factoring in both hard and soft costs. The Oversight Board notes this is 51% higher than the average of the eight (8) similar 2–4 bedroom unit HFA LIHTC projects approved by the Oversight Board. Furthermore, the Proposed Debt Transaction estimates that 45% of the total development costs to be financed through the federal programs are attributable to soft costs and developer costs, an amount higher than in any of the prior HFA transactions reviewed by the Oversight Board under Section 207. The Oversight Board would like to understand how HFA will ensure these federal programs provide the maximum number of affordable units available as part of the Commonwealth's affordable housing initiatives. *(See Appendix B)*

2. **Projected operating deficit:** The Proposed Debt Transaction will be partially used to establish a $7.8M operating reserve to cover the project's anticipated losses due to the high unit economics. Specifically, the project forecasts an annual operating expense of $7.3k per unit, 78% higher than the average $4.1k per unit per year for similar projects. The high level of cost on a per unit basis results in a per unit operating loss of $2.1k in the first year and is projected to increase over time. Additionally, the project schedules provided by the parties forecast an annual operating deficit for the first 20 years, which is why the parties are establishing the $7.8M operating reserve as the mechanism to enable feasibility. The Oversight Board would like to better understand the decision to fund an unsustainable business enterprise with annual operating losses. The operating reserve would be better suited to build additional low-income units in a more cost-efficient manner. While the Developer and Owner of the project plan to re-syndicate the project to obtain additional financing, the Oversight Board is concerned on the reliance of additional federal funds utilized to finance a projected $21.8M deficit in years 21-40. *(See Appendix C)*

3. **Program oversight and strategy:** It is not clear whether HFA, DOH, and AAFAF have a robust, multi-year, strategic plan regarding the development of affordable housing, which may result in questionable projects, limited diligence, and undefined thresholds. Ultimately, this may limit the opportunity to maximize housing units and risk underutilizing federal funds for affordable housing. The 2020 Qualified Allocation Plan (QAP) and the DOH July 2025 Housing Plan lay out several measures to maximize funds. Notably, the DOH reports that the average development cost per unit is estimated at $300k, which is in contrast to the per unit costs of $736k in the Proposed Debt Transaction. The Oversight Board would like to understand the long-term program strategy to address the affordable housing crisis impacting the island and ensure that the HFA, DOH, and Commonwealth have a harmonized and long-term plan for affordable housing across the island. *(See Appendix D)*

4. **Bidding Process:** The Oversight Board would like to better understand the procurement process and how the QAPs and NOFAs are broadly disseminated and marketed to bring the best proponents into the bidding process, ensuring healthy competition for cost while maximizing the number of units developed under the program by having numerous credentialed proponents involved.

Meeting Required prior to Decision by the Oversight Board

While the agencies have made progress in advancing affordable housing initiatives on the island, the characteristics of the Proposed Debt Transaction brings into question whether federal funds are being maximized. Based upon the high cost per unit, it appears that, while the project does provide affordable housing on the island to benefit those most in need, there is potential for projects of this nature to provide unequal benefits to the private sector participants, including developers, banks, and construction companies.

The Oversight Board strongly supports leveraging federal funds to expand affordable housing on the island given significant need. However, the Oversight Board has concerns about the economics and financial sustainability of this particular project. We understand that these programs will continue through future QAPs and NOFAs; therefore, we would like to understand in greater detail how each agency evaluates and addresses these concerns.

Moreover, the Oversight Board would like to understand the harmonized strategy and long-term plan of each of the agencies to address affordable housing across the island. The Oversight Board envisions such a strategy would incorporate inter-agency collaboration, oversight, and financial thresholds as designed to maximize future federal funds in order to assist the greatest number of citizens in need of affordable housing.

As a result, **the Oversight Board requests a joint meeting with the DOH, the HFA, and AAFAF at their earliest convenience, prior to December 19, 2025.**

We appreciate each agency's efforts in providing access to financing programs for the development of affordable housing across Puerto Rico and we look forward to continuing our work together for the benefit of Puerto Rico and its residents.

Sincerely,

Robert F. Mujica, Jr.
Executive Director

CC: The Honorable Ramón L. Rivera Cruz
Ms. Vicky K. Gonzalez-Vega
Mr. Ricardo Álvarez
Mr. Omar Figueroa, Esq.
Mr. Efrain Maldonado

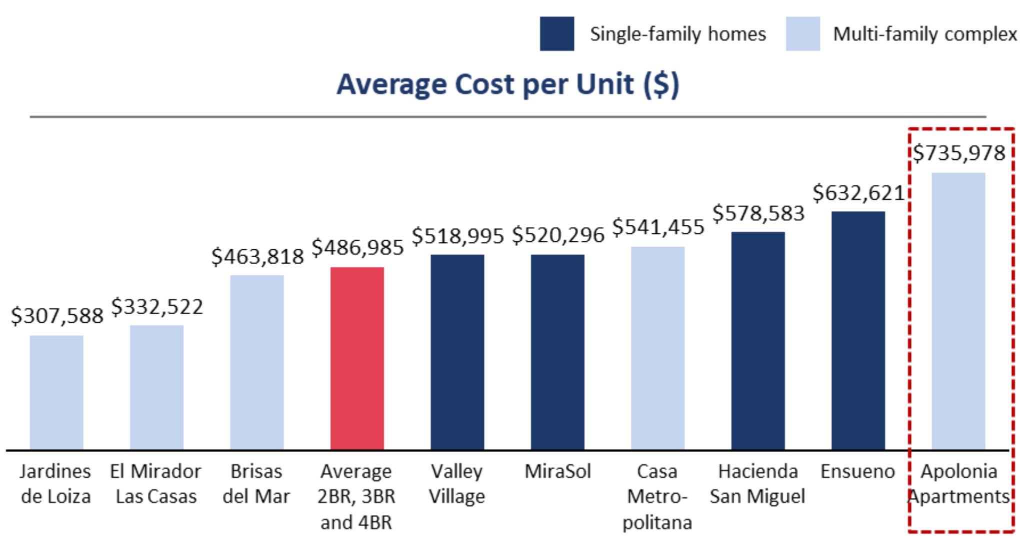
Appendix A: Overview of 207 Project Submission

The Proposed Debt Transaction, as described and represented in the Supporting Materials, consists of a request for authorization for the HFA to enter into a credit agreement with Banco Popular de Puerto Rico ("Banco Popular") in an amount up to $45,000,000 to assist in financing the construction of an affordable rental housing project in the Municipality of Bayamón. The Proposed Debt Transaction contemplates that the proceeds will be lent to Puerto Rico Apolonia Apartments, LLC as the HFA borrower to finance the new construction of 138 2-3 bedroom units and to cover the financing and legal costs of the Proposed Debt Transaction.

As represented in the Supporting Materials, the Proposed Debt Transaction is a non-recourse obligation to HFA issued to access tax-exempt financing pursuant to the HUD and HFA 2020 Qualified Affordable Housing Program and will not be guaranteed by HFA, the Government of Puerto Rico, or any of its agencies, public corporations, and instrumentalities. Proceeds of the transaction are to be repaid through disbursements of Federal Funds, specifically Community Disaster Block Grant–Disaster Relief funds and Low-Income Housing Tax Credit funds. Repayment is not contingent on cash flows from the project and will be repaid by the end of construction. All fees of the transaction, including any fees imposed by AAFAF, will be funded by the HFA borrower.

Appendix B: Highest cost compared to peers

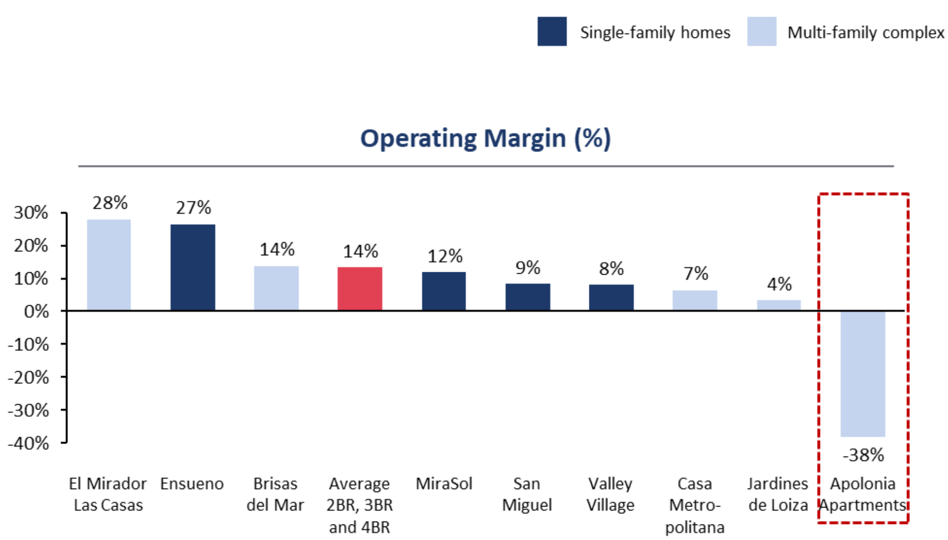
While HFA is seeking authorization to enter into a credit agreement with Banco Popular to issue $45M of tax-exempt debt, the full estimated cost of the project is $101.6M. Irrespective of hard and soft costs for each of the 138 units, the total cost per unit of the project is $736k. When considering hard and soft costs, this project reflects the highest hard costs per unit ($395k) and soft costs per unit ($340k) compared to similar HFA LIHTC projects. We understand that hard costs may be higher because this project complies with Green Building standards and updated building codes, implements broadband infrastructure, allocates 12% of units as ADA compliant, and allocates 3% of units as sensory-accessible, among other factors. These high costs can also be attributed, in part, to additional amenities provided to tenants, including a community center and exercise room.



Appendix C: Unsustainable operating costs

Operating deficits may arise in rental projects when operating expenses are higher than rental income, though they are usually short-term in nature. We understand that "PRHFA and developers are facing a challenge in forecasting the 30 [year] operations of LIHTC projects."[1] Notwithstanding, this project forecasts an annual per unit operating expense of $7.3k, 78% higher than similar projects, which average $4.1k per unit per year. In conversation, AAFAF and HFA were unable to articulate whether other affordable housing projects are facing a similar operating deficit due to increased annual costs and stated that the increase in annual expenses is unique to the Apolonia project.

- **Reserves:** While future operating costs may be uncertain, this transaction budgets $7.8M in a capitalized operating reserve fund. These funds are intended to subsidize 20 years of projected operating deficits.
    a. Should this project incur an annual operating deficit, federal LIHTC disbursements will ultimately fund an unsustainable business enterprise. Should this project not incur an annual operating deficit, "the remainder will be put back into reserves and/or be used to pay other eligible costs." Instead of building units, LIHTC is used to fund project operating losses.
    b. Additionally, whether the project incurs an operating deficit or not, by capitalizing a $7.8M reserve to safeguard an untenable operation, total project costs increase, and the developer is able to gain incremental fees as a result.
- **Resyndication:** The QAP application asserts this project will be dedicated to low-income families for 40 years.[2] The projected deficit from years 21-40 will be $21.8M, in addition to the $7.8M deficit until year 20. As a result, "the Developer/Owner's plan is to re-syndicate after the initial compliance period (15 years) to secure new funding in order to preserve the property as affordable housing."[3] Among other factors, this would entail relying on additional federal subsidies for an untenable operation by "refinancing the project through a new round of tax credits."[4] HFA and AAFAF appear comfortable with the project operating at a perpetual annual loss and the plan to resyndicate after 15 years.



[1] Topics for Discussion-by MMJ 28OCT25 (rev. hes 4NOV25)
[2] 2020 QAP Application #15, Project Narrative Information
[3,4] October 31, 2025, email correspondence between FOMB and AAFAF

Appendix D: Program oversight and strategy

Explicit statements made in the methodologies and criteria of the 2020 QAP include the following:

§ 5.1.1.4: Financial and Operational Feasibility – Proposed detail of sources and uses of funds schedule and construction cash flow. Projected thirty (30) year pro-forma income and expense cash flow (or any other period, as applicable) showing a feasible operation.

- Considering that the pro forma statements reflect 30 years of negative cash flows, these operating losses place additional risk on the sustainability of the project and raise concerns as to the financial and operational feasibility of the project.

§ 5.2.2.5: Per-Unit Cost Review – The Authority may appoint an independent consultant to validate the construction or rehabilitation costs in projects that passed the basic threshold requirements.

- While a technical feasibility and cost reasonableness review is performed, it appears that thresholds relating to per-unit costs are "determined by the PRDOH and HFA [is] not part of this process."[5] This indicates potential disjointed strategies between HFA and DOH with respect to the threshold determination and diligence processes.

§ 5.2.3.4: Operating Expenses – The Authority will consider the reasonableness of the development and operational costs of the project as an additional factor in determining the proper amount of Tax Credits.

§ 5.2.4, Criterion V.6: Operating Expenses – A project [may] be awarded [points] if it meets … corresponding operating expense requirement on a per-unit per-annum (PUPA) basis in the first year.

[5] Topics for Discussion-by MMJ 28OCT25 (rev. hes 4NOV25)