

# Puerto Rico Housing Finance Authority

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

OMB Circular A-133 Audit for the  
Year Ended June 30, 2010, and  
Independent Auditors' Reports

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

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**PUERTO RICO HOUSING FINANCE AUTHORITY**

**PART I**

**BASIC FINANCIAL STATEMENTS, REQUIRED  
SUPPLEMENTARY INFORMATION, AND  
ADDITIONAL SUPPLEMENTARY INFORMATION**

## INDEPENDENT AUDITORS' REPORT

To the Members of the Board of Directors of  
Puerto Rico Housing Finance Authority:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Puerto Rico Housing Finance Authority (the "Authority"), a component unit of Government Development Bank for Puerto Rico, as of and for the year ended June 30, 2010, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on the respective financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the Authority, as of June 30, 2010, and the respective changes in financial position and respective cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 to 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Authority's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the Authority's respective financial statements that collectively comprise the Authority's basic financial statements. The additional supplementary information listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements (which includes the schedule of expenditures of federal awards, as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local*

*Governments, and Non-Profit Organizations*). This additional supplementary information is the responsibility of the Authority's management. Such information has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 5, 2010, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*Deloitte & Touche LLP*

November 5, 2010

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**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**AS OF AND FOR THE YEAR ENDED JUNE 30, 2010**

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This section presents a narrative overview of the financial performance of Puerto Rico Housing Finance Authority (the "Authority") as of and for the year ended June 30, 2010. The information presented here should be read in conjunction with the Authority's basic financial statements, including the notes thereto.

**1. FINANCIAL HIGHLIGHTS**

- Net assets of the Authority increased \$28 million, from \$606 million as of June 30, 2009, to \$634 million as of June 30, 2010. The increase was the net result of a decrease in the net assets of governmental activities of \$30 million and an increase of \$58 million in the net assets of business-type activities.
- Operating income of enterprise fund activities was \$20 million and \$25 million for the years ended June 30, 2010 and 2009, respectively. Total operating revenues of enterprise funds increased to \$116 million in 2010 from \$113 million in 2009. Total operating expenses increased to \$96 million in 2010 from \$88 million in 2009. There were interfund transfers in the amount of \$5 million and operating contributions from the Commonwealth of Puerto Rico (the "Commonwealth") of \$34 million during the year ended June 30, 2010.
- The Authority's board of directors authorized to close the Special Obligation Refunding Bonds — Debt Service fund and transfer its net assets to the Affordable Housing Mortgage Subsidy Program (AHMSP) Stage 7 fund. The purpose of this transfer was to reduce a fund balance deficit of the AHMSP Stage 7 fund and also reduce liabilities for \$13 million.
- The Authority's board of directors authorized to return \$32 million from The Key to Your Home Program and the AHMSP Act No. 124 to the Operating and Administrative fund. These funds had been previously transferred in 2007 to these governmental funds as a result of a refunding bond transaction.
- The Authority's board of directors authorized the use of \$21 million from the Operating and Administrative fund for the creation of the Closing Costs Assistance Program. The purpose of this program is to promote the origination of single-family mortgage loans through a subsidy that covers the closing costs. For the year ended June 30, 2010, total subsidies charged to this program amounted to \$26.4 million.
- On February 17, 2009, the American Recovery and Reinvestment Act (ARRA) was signed into law in the United States of America. The purpose of ARRA is to jumpstart the nation's ailing economy, with a primary focus on creating and savings jobs in the near term and investing in infrastructure that will provide long-term economic benefits. During the year ended June 30, 2010, the Authority expended \$86.6 million as part of this act.

- In February 2010, the Commonwealth made a \$904,850 contribution to the Authority for the interest payment of its \$13.9 million line of credit of the AHMSP Stage 10 fund.
- During the current year, the Commonwealth awarded a \$10 million contribution to the Authority for the Closing Costs Assistance Program.
- On April 22, 2010, the Authority issued \$15 million of Special Obligation Notes, 2010 Series A. The proceeds from these notes will be used to acquire the second mortgages originated under the Home Purchase Stimulus Program and will also be used as collateral of the Notes. A subsequent issuance of Special Obligation Notes, Series B is expected to occur in November 2010.

## **2. OVERVIEW OF THE FINANCIAL STATEMENTS**

The financial statements consist of three parts, management's discussion and analysis (this section), the basic financial statements and additional supplementary information. The basic financial statements include two types of statements that present different views of the Authority:

- The first two statements are the government-wide financial statements that provide information about the Authority's overall financial position and results. These statements, which are presented on the accrual basis of accounting, consist of the statement of net assets and the statement of activities.
- The remaining statements are fund financial statements of the Authority's major and nonmajor governmental funds, for which activities are funded primarily from Commonwealth appropriations and for which the Authority follows the modified accrual basis of accounting, and of the Authority's major and nonmajor enterprise funds, which operate similar to business activities and for which the Authority follows the accrual basis of accounting.
- The basic financial statements also include the notes to financial statements section that explains some of the information in the government-wide and fund financial statements and provides more detailed data.
- The notes to the basic financial statements are followed by a supplementary information section, which presents information of the fund financial statements of nonmajor funds for governmental and business-type activities.

The government-wide financial statements report information about the Authority as a whole using accounting methods similar to those used by private sector companies. The statement of net assets includes all of the Authority's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when the cash is received or paid.

### 3. FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the Authority's most significant funds and not the Authority as a whole. The Authority has two types of funds:

**Governmental Funds** — Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, government fund financial statements focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Authority's near term financial requirements.

**Enterprise Funds** — The Authority's primary activities are included in its enterprise funds, which are accounted for in a manner similar to businesses operating in the private sector. Funding has primarily arisen through accumulated enterprise earnings, the issuance of tax-exempt bonds, the proceeds of which are primarily used to grant various types of loans to finance low and moderate-income housing. The net assets of these funds represent earnings accumulated since their inception, and are generally restricted for program purposes.

### 4. FINANCIAL ANALYSIS OF THE AUTHORITY AS A WHOLE

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, 2010 and June 30, 2009 (in thousands):

	Governmental		Business-type		Total	
	Activities		Activities			
	2010	2009	2010	2009	2010	2009
<b>Assets:</b>						
Cash	\$ 6,868	\$ 3,301	\$ 31,655	\$ 25,125	\$ 38,523	\$ 28,426
Investments, investment contracts, and deposits placed with banks	117,044	158,589	1,264,835	1,411,396	1,381,879	1,569,985
Loans receivable, net		2,063	208,135	202,691	208,135	204,754
Capital assets			3,601	4,159	3,601	4,159
Other assets, net of internal balances	27,449	(5,530)	36,407	46,576	63,856	41,046
<b>Total assets</b>	<b>151,361</b>	<b>158,423</b>	<b>1,544,633</b>	<b>1,689,947</b>	<b>1,695,994</b>	<b>1,848,370</b>
<b>Liabilities:</b>						
Current liabilities	89,507	84,532	100,228	76,817	189,735	161,349
Long-term liabilities	63,433	45,015	809,169	1,036,170	872,602	1,081,185
<b>Total liabilities</b>	<b>152,940</b>	<b>129,547</b>	<b>909,397</b>	<b>1,112,987</b>	<b>1,062,337</b>	<b>1,242,534</b>
<b>Net assets (deficiency):</b>						
Invested in capital assets			3,601	4,159	3,601	4,159
Restricted	52,933	93,609	296,977	231,811	349,910	325,420
Unrestricted	(54,512)	(64,733)	334,658	340,990	280,146	276,257
<b>Total</b>	<b>\$ (1,579)</b>	<b>\$ 28,876</b>	<b>\$ 635,236</b>	<b>\$ 576,960</b>	<b>\$ 633,657</b>	<b>\$ 605,836</b>

The net assets of the Authority increased \$28 million from \$606 million at June 30, 2009 to \$634 million at June 30, 2010 as a result of a decrease of \$152 million in total assets and \$180 million in total liabilities. The decrease in total assets is mainly due to the following:

- Investments, investment contracts, and deposits placed with banks decreased from \$1,570 million at June 30, 2009 to \$1,382 million at June 30, 2010 or a \$188 million decrease. This decrease was principally the result of the use of investments to partially redeem \$181 million of Single-Family Mortgage Revenue Bonds Portfolio XI.
- Other assets increased from \$41 million at June 30, 2009 to \$64 million at June 30, 2010 or an increase of \$23 million. This increase is the result of the due from federal government recorded in the ARRA Programs.

The changes in total liabilities are mainly due to the following:

- Current liabilities increased from \$161 million at June 30, 2009 to \$190 million at June 30, 2010 or \$29 million. The increase was mainly the result of activities in 2010 of the new Closing Costs Assistance Program, ARRA Programs, and Home Purchase Stimulus Program with aggregate accounts payable and accrued liabilities of \$54 million. The increase was partially offset by the redemption of bonds and notes during the year.
- Long term liabilities decreased from \$1,081 million at June 30, 2009 to \$873 million at June 30, 2010 or \$208 million. This reduction was principally the result of an early redemption of \$181 million on bonds of the Single-Family Mortgage Revenue Bonds Portfolio XI; \$164 million in October 2009 and \$16.5 million in May 2010.

## 5. STATEMENT OF ACTIVITIES

The statement of activities shows the sources of the Authority's changes in net assets as they arise through its various programs and functions. Programs such as the Housing and Urban Development (HUD) Programs, ARRA Programs, and the Closing Costs Assistance Program, are shown as governmental activities, and other programs (Operating and Administrative, Single-Family Mortgage Revenue Bonds Portfolio IX, and Mortgage Loan Insurance) are shown as business-type activities. Condensed statements of activities for the fiscal years ended June 30, 2010 and 2009 are shown in the table below (in thousands):

	Governmental Activities		Business-type Activities		Total	
	2010	2009	2010	2009	2010	2009
Revenues:						
Program revenues:						
Charges for services	\$ -	\$ -	\$ 11,114	\$ 11,391	\$ 11,114	\$ 11,391
Financing and investment	4,743	6,616	104,413	101,322	109,156	107,938
Operating grants and contributions	<u>225,268</u>	<u>127,411</u>	<u>34,000</u>		<u>259,268</u>	<u>127,411</u>
Total revenues	<u>230,011</u>	<u>134,027</u>	<u>149,527</u>	<u>112,713</u>	<u>379,538</u>	<u>246,740</u>
Program expenses:						
General government and other	4,776	4,555			4,776	4,555
Housing assistance programs	250,787	177,085			250,787	177,085
Operating and administrative			31,742	15,652	31,742	15,652
Mortgage Trust III			32,620	33,599	32,620	33,599
Single Family Mortgage Revenue						
Bonds — Portfolio IX			6,737	7,051	6,737	7,051
Mortgage-Backed Certificates 2006 Series A			7,415	7,704	7,415	7,704
Other business-type activities			<u>17,639</u>	<u>24,018</u>	<u>17,639</u>	<u>24,018</u>
Total expenses	<u>255,563</u>	<u>181,640</u>	<u>96,153</u>	<u>88,024</u>	<u>351,716</u>	<u>269,664</u>
Change in net assets before transfers	(25,552)	(47,613)	53,374	24,689	27,822	(22,924)
Transfers	<u>(4,902)</u>	<u>(6,609)</u>	<u>4,902</u>	<u>6,609</u>		
Change in net assets	(30,454)	(54,222)	58,276	31,298	27,822	(22,924)
Net assets — beginning of year	<u>28,875</u>	<u>83,097</u>	<u>576,960</u>	<u>545,662</u>	<u>605,835</u>	<u>628,759</u>
Net assets (deficiency) — end of year	<u>\$ (1,579)</u>	<u>\$ 28,875</u>	<u>\$ 635,236</u>	<u>\$ 576,960</u>	<u>\$ 633,657</u>	<u>\$ 605,835</u>

- Total revenues increased from \$247 million in 2009 to \$380 million in 2010 or \$133 million. Operating grants and contributions increased by \$132 million when compared to the prior year. Operating grants and contributions increased from \$127 million in 2009 to \$259 million in 2010 mainly because this year the Authority earned \$86.6 million in ARRA funds. This federal program was not established last year. In addition, the Authority received \$34 million from the Commonwealth for the co-participation program and the Home Purchase Stimulus Program.
- Program expenses increased from \$270 million in 2009 to \$352 million in 2010 or \$82 million. The increase in expenses of governmental activities was mainly due to an increase of \$86.6 million in expenditures of ARRA Programs.

## 6. 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. 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 certain markets. The expenditures of the HUD programs increased \$6 million from \$119 million in 2009 to \$125 million in 2010. The expenditures in the housing vouchers program increased \$1 million because additional vouchers were awarded when compared to the previous year.

**ARRA Programs** — On February 17, 2009, ARRA was signed into law in the United States of America. The purpose of ARRA is to jumpstart the nation's ailing economy, with a primary focus on creating and savings jobs in the near term and investing in infrastructure that will provide long-term economic benefits. During the year ended June 30, 2010, the Authority expended \$86.6 million as part of this program.

**Closing Costs Assistance Program** — This program was created to provide subsidy to families to cover closing costs related to the purchase of housing units, subject to certain maximum amounts. During this year, the program received \$21 million from the Operating and Administrative fund and other \$10 million from the Commonwealth. During the year ended June 30, 2010, total subsidy expenditures amounted to \$26.4 million.

## 7. ENTERPRISE FUND RESULTS

Total net assets of the Authority's enterprise funds increased during the year ended June 30, 2010, by \$58 million. Following is an analysis of the financial position and results of operations of the major enterprise funds:

**Operating and Administrative** — The net assets of the Operating and Administrative fund increased from \$345 million at June 30, 2009 to \$368 million at June 30, 2010 or \$23 million. The change in net assets decreased from \$31 million in 2009 to \$23 million in 2010 or a change of \$8 million, which was mainly due to fluctuations in the operating expenses, special items, and interfund transfers financial statements line items. Operating expenses went from \$16 million in 2009 to \$32 million in 2010. The Authority's board of directors authorized to return \$32 million from The Key to Your Home Program and the AHMSP Act. No. 124 Program to the Operating and Administrative fund. These funds were previously transferred in 2007 to the governmental funds as a result of a refunding bond transaction. The Authority's board of directors also authorized the use of \$21 million for the creation of the Closing Costs Assistance Program.

**Mortgage Trust III** — Investment income and interest income on loans for 2010 amounted to \$41 million while interest expense and fees amounted to \$33 million during the year ended June 30, 2010. Since the bonds accounted for in this fund are zero-coupon bonds, interest payments are not required to be made until maturity. During the year, the fund made principal payments of \$43 million on matured bonds.

**Single Family Mortgage Revenue Bonds Portfolio IX** — This fund had investment income of \$12 million and incurred in interest expense on bonds payable of \$7 million.

**Mortgage-Backed Certificates 2006 Series A** — This fund had investment income of \$14 million and incurred in interest expense on bonds payable of \$7 million. During the year, this fund paid \$11.8 million of mortgage-backed certificates payable.

## **8. CAPITAL ASSETS**

The Authority's investment in capital assets for its business-type activities at June 30, 2010 and 2009, amounted to approximately \$3.6 million and \$4.2 million, respectively, net of accumulated depreciation and amortization. Capital assets include leasehold improvements, information systems, office furniture, equipment, and vehicles.

## **9. 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.

At June 30, 2010 and June 30, 2009, total debt outstanding amounted to \$982 million and \$1,215 million, respectively. Debt issuances during 2010 and 2009 totaled \$32.0 million and \$8.7 million, respectively. Debt issued in 2010 consisted of approximately \$2.8 million from a revolving credit facility with Government Development Bank for Puerto Rico (GDB) under the co-participation program, \$7.6 million of Special Obligation Notes, 2010 Series A under the Home Purchase Stimulus Program, \$14.3 million from a note payable to GDB under its AHMSP Stage 10 fund, and \$7.3 million under the New Secure Housing Program's line of credit. Debt repaid during fiscal year 2010 and 2009 amounted to approximately \$298 million and \$225 million, respectively. During the year ended June 30, 2010, the amounts of \$31 million and \$267 million were repaid in the governmental and business-type activities, respectively.

## **10. REQUESTS FOR INFORMATION**

This financial report is designed to provide a general overview of the Puerto Rico Housing Finance 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 Government Development Bank for Puerto Rico)

**STATEMENT OF NET ASSETS (DEFICIENCY)**  
**AS OF JUNE 30, 2010**

	Governmental Activities	Business-Type Activities	Total
<b>ASSETS</b>			
Cash	\$ -	\$ 6,732,429	\$ 6,732,429
Deposits placed with banks		116,131,209	116,131,209
Investments and investment contracts		18,357,183	18,357,183
Loans receivable — net		191,347,183	191,347,183
Interest and other receivables		2,470,582	2,470,582
Other assets		58,215	58,215
Internal balances — net	(2,112,001)	2,112,001	-
Restricted assets:			
Cash	6,868,220	24,922,414	31,790,634
Deposits placed with banks	8,049,335	405,306,936	413,356,271
Investments and investment contracts	108,995,150	725,039,969	834,035,119
Interest and other receivables	1,475,285	13,954,190	15,429,475
Due from federal government	22,893,098		22,893,098
Due from Commonwealth of Puerto Rico	5,000,000		5,000,000
Loans receivable — net		16,787,580	16,787,580
Real estate available for sale		1,339,669	1,339,669
Deferred debt issue costs	191,908	6,165,742	6,357,650
Real estate available for sale		1,425,894	1,425,894
Property held in trust for Puerto Rico			
Department of Housing		8,880,000	8,880,000
Capital assets — net		3,601,354	3,601,354
Total assets	<u>\$ 151,360,995</u>	<u>\$ 1,544,632,550</u>	<u>\$ 1,695,993,545</u>
<b>LIABILITIES AND NET ASSETS (DEFICIENCY)</b>			
<b>LIABILITIES:</b>			
Accounts payable and accrued liabilities	\$ -	\$ 9,361,535	\$ 9,361,535
Due to Government Development Bank for Puerto Rico — due in more than one year		3,495,586	3,495,586
Notes payable — due in more than one year	4,811,237		4,811,237
Liabilities payable from restricted assets:			
Accounts payable and accrued liabilities	47,136,858	21,820,208	68,957,066
Accrued interest payable	256,831	1,440,545	1,697,376
Due to Government Development Bank for Puerto Rico:			
Due in one year	42,113,113		42,113,113
Due in more than one year	58,622,234		58,622,234
Bonds and mortgage-backed certificates payable:			
Due in one year		67,605,173	67,605,173
Due in more than one year		805,673,677	805,673,677
Total liabilities	<u>152,940,273</u>	<u>909,396,724</u>	<u>1,062,336,997</u>
<b>COMMITMENTS AND CONTINGENCIES (Note 13)</b>			
<b>NET ASSETS (DEFICIENCY):</b>			
Invested in capital assets		3,601,354	3,601,354
Restricted for:			
Mortgage loan insurance		61,898,797	61,898,797
Affordable housing program	52,933,292	230,895,407	283,828,699
Other housing programs		4,182,693	4,182,693
Unrestricted net assets (deficit)	<u>(54,512,570)</u>	<u>334,657,575</u>	<u>280,145,005</u>
Total net assets (deficiency)	<u>\$ (1,579,278)</u>	<u>\$ 635,235,826</u>	<u>\$ 633,656,548</u>

See accompanying notes to basic financial statements.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**STATEMENT OF ACTIVITIES**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets		Total
		Charges for Services — Fees, Commissions, and Others	Charges for Services — Financing and Investment	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	
<b>FUNCTIONS/PROGRAMS:</b>							
Governmental activities:							
General government and other	\$ 4,776,401	\$ -	\$ -	\$ -	\$ (4,776,401)	\$ -	\$ (4,776,401)
Housing assistance programs	<u>250,787,193</u>		<u>4,743,015</u>	<u>225,267,928</u>	<u>(20,776,250)</u>		<u>(20,776,250)</u>
Total governmental activities	<u>255,563,594</u>	<u>-</u>	<u>4,743,015</u>	<u>225,267,928</u>	<u>(25,552,651)</u>	<u>-</u>	<u>(25,552,651)</u>
Business-type activities:							
Operating and administrative	31,741,573	7,792,599	15,636,660	29,500,000		21,187,686	21,187,686
Mortgage Trust III	32,619,646		40,683,707			8,064,061	8,064,061
Single Family Mortgage Revenue Bonds Portfolio IX	6,736,928		11,688,162			4,951,234	4,951,234
Mortgage-Backed Certificates 2006 Series A	7,415,574		13,630,631			6,215,057	6,215,057
Other business-type activities	<u>17,639,277</u>	<u>3,321,287</u>	<u>22,773,934</u>	<u>4,500,000</u>		<u>12,955,944</u>	<u>12,955,944</u>
Total business-type activities	<u>96,152,998</u>	<u>11,113,886</u>	<u>104,413,094</u>	<u>34,000,000</u>	<u>-</u>	<u>53,373,982</u>	<u>53,373,982</u>
Total functions/programs	<u>\$351,716,592</u>	<u>\$11,113,886</u>	<u>\$109,156,109</u>	<u>\$259,267,928</u>	<u>(25,552,651)</u>	<u>53,373,982</u>	<u>27,821,331</u>
TRANSFERS IN (OUT) — Net					<u>(4,902,162)</u>	<u>4,902,162</u>	<u>-</u>
CHANGE IN NET ASSETS					<u>(30,454,813)</u>	<u>58,276,144</u>	<u>27,821,331</u>
NET ASSETS — Beginning of year					<u>28,875,535</u>	<u>576,959,682</u>	<u>605,835,217</u>
NET ASSETS (DEFICIENCY) — End of year					<u>\$ (1,579,278)</u>	<u>\$635,235,826</u>	<u>\$633,656,548</u>

See accompanying notes to basic financial statements.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**BALANCE SHEET — GOVERNMENTAL FUNDS**  
**AS OF JUNE 30, 2010**

	HUD Programs	ARRA Programs	Closing Costs Assistance Program	Other Nonmajor	Eliminations	Total
<b>ASSETS</b>						
DUE FROM OTHER FUNDS	\$ -	\$ -	\$ -	\$ 20,015	\$ (71)	\$ 19,944
RESTRICTED:						
Cash	1,660,169	183	3,023,288	2,184,580		6,868,220
Deposits placed with banks			8,047,530	1,805		8,049,335
Investments and investment contracts				108,995,150		108,995,150
Interest and other receivables	1,216,140	6	50,724	208,415		1,475,285
Due from federal government	999,823	21,893,275				22,893,098
Due from Commonwealth of Puerto Rico			5,000,000			5,000,000
<b>TOTAL</b>	<b>\$ 3,876,132</b>	<b>\$ 21,893,464</b>	<b>\$ 16,121,542</b>	<b>\$ 111,409,965</b>	<b>\$ (71)</b>	<b>\$ 153,301,032</b>
<b>LIABILITIES AND FUND BALANCES</b>						
LIABILITIES:						
Due to other funds	\$ 1,235,972	\$ -	\$ 24,014	\$ 872,030	\$ (71)	\$ 2,131,945
Payable from restricted assets:						
Accounts payable and accrued liabilities	2,640,160	21,893,464	11,301,874	11,301,360		47,136,858
Due to Government Development Bank for Puerto Rico				39,295,920		39,295,920
<b>Total liabilities</b>	<b>3,876,132</b>	<b>21,893,464</b>	<b>11,325,888</b>	<b>51,469,310</b>	<b>(71)</b>	<b>88,564,723</b>
FUND BALANCES —						
Unreserved — special revenue funds			4,795,654	59,940,655		64,736,309
<b>TOTAL</b>	<b>\$ 3,876,132</b>	<b>\$ 21,893,464</b>	<b>\$ 16,121,542</b>	<b>\$ 111,409,965</b>	<b>\$ (71)</b>	<b>\$ 153,301,032</b>

See accompanying notes to basic financial statements.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**RECONCILIATION OF THE BALANCE SHEET — GOVERNMENTAL FUNDS TO THE  
STATEMENT OF NET ASSETS (DEFICIENCY)  
AS OF JUNE 30, 2010**

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AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES  
IN THE STATEMENT OF NET ASSETS (DEFICIENCY) ARE  
DIFFERENT BECAUSE:

Total fund balances	\$ 64,736,309
Deferred debt issue costs that are recorded as expenditures in governmental funds, but are capitalized in the government-wide financial statements	191,908
Notes payable are not due and payable in the current period and, therefore, are not reported in the funds	(66,250,664)
Accrued interest payable not due and payable in the current period	<u>(256,831)</u>
NET DEFICIENCY OF GOVERNMENTAL ACTIVITIES	<u>\$ (1,579,278)</u>

See accompanying notes to basic financial statements.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES — GOVERNMENTAL FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	HUD Programs	ARRA Programs	Closing Costs Assistance Program	Other Nonmajor	Total
REVENUES:					
Commonwealth appropriations for repayment of bonds or housing assistance programs	\$ -	\$ -	\$ 10,000,000	\$ 1,161,681	\$ 11,161,681
Intergovernmental — federal government	124,519,535	86,636,311			211,155,846
Interest income on deposits placed with banks			43,392	90,621	134,013
Interest income on investments and investment contracts				4,537,792	4,537,792
Interest income on loans				27,617	27,617
Net increase in fair value of investments				43,593	43,593
Net gain on sale of foreclosed real estate available for sale				93,800	93,800
Other	40,073			1,587,338	1,627,411
<b>Total revenues</b>	<b>124,559,608</b>	<b>86,636,311</b>	<b>10,043,392</b>	<b>7,542,442</b>	<b>228,781,753</b>
CURRENT EXPENDITURES:					
Current:					
General government and other	4,679,791			96,610	4,776,401
Housing assistance programs	119,879,817	86,636,311	26,415,427	14,081,341	247,012,896
Debt service:					
Principal				1,851,918	1,851,918
Interest				3,159,101	3,159,101
<b>Total expenditures</b>	<b>124,559,608</b>	<b>86,636,311</b>	<b>26,415,427</b>	<b>19,188,970</b>	<b>256,800,316</b>
DEFICIENCY OF REVENUES UNDER EXPENDITURES	-	-	(16,372,035)	(11,646,528)	(28,018,563)
OTHER FINANCING SOURCES (USES):					
Proceeds from issuance of long-term debt				20,527,563	20,527,563
Transfers in			21,167,689	44,396,172	65,563,861
Transfers out				(70,466,023)	(70,466,023)
<b>Total other financing sources (uses) — net</b>	<b>-</b>	<b>-</b>	<b>21,167,689</b>	<b>(5,542,288)</b>	<b>15,625,401</b>
NET CHANGES IN FUND BALANCES		-	4,795,654	(17,188,816)	(12,393,162)
FUND BALANCES — Beginning of year				77,129,471	77,129,471
FUND BALANCES — End of year	\$ -	\$ -	\$ 4,795,654	\$ 59,940,655	\$ 64,736,309

See accompanying notes to basic financial statements.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of 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, 2010**

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AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE  
STATEMENT OF ACTIVITIES ARE DIFFERENT BECAUSE:

Net changes in fund balances — total governmental funds	\$ (12,393,162)
The issuance of long-term debt provides current financial resources while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds; neither transaction, however, has any effect on net assets	(18,675,645)
Some expenses in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds	(477,197)
Revenues in the statement of activities that do provide current financial resources and not reported as revenues in the governmental funds	1,229,190
Governmental funds report the effect of issuance costs when debt is first issued, whereas these costs are deferred and amortized in the statement of activities. This amount is the amortization for the year.	<u>(137,999)</u>
<b>CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES</b>	<b><u>\$ (30,454,813)</u></b>

See accompanying notes to basic financial statements.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**BALANCE SHEET — ENTERPRISE FUNDS**  
**AS OF JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Eliminations	Total
<b>ASSETS</b>							
<b>CURRENT ASSETS:</b>							
Cash	\$ 6,732,429	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,732,429
Deposits placed with banks	116,131,209						116,131,209
Loans receivable — net	5,327,000						5,327,000
Accrued interest receivable	1,418,509						1,418,509
Other current receivables	1,052,073						1,052,073
Other assets	58,215						58,215
Due from other funds	2,297,346				5,482	(170,883)	2,131,945
Restricted:							
Cash		7,718,626			17,203,788		24,922,414
Deposits placed with banks	29,500,000	314,585,455	57,334		61,164,147		405,306,936
Accrued interest receivable		11,391,229	507,852	634,373	1,268,171		13,801,625
Other receivables		5,365			147,200		152,565
Investments and investment contracts		10,109			560,873		570,982
Loans receivable — net		528,000					528,000
Total current assets	<u>162,516,781</u>	<u>334,238,784</u>	<u>565,186</u>	<u>634,373</u>	<u>80,349,661</u>	<u>(170,883)</u>	<u>578,133,902</u>
<b>NONCURRENT ASSETS:</b>							
Investments and investment contracts	18,357,183						18,357,183
Loans receivable — net	186,020,183						186,020,183
Real estate available for sale	1,425,894						1,425,894
Property held in trust for Puerto Rico							
Department of Housing	8,880,000						8,880,000
Capital assets — net	3,601,354						3,601,354
Restricted:							
Investments and investment contracts		213,419,269	123,915,473	144,579,382	242,554,863		724,468,987
Loans receivable — net		2,752,026			13,507,554		16,259,580
Real estate available for sale					1,339,669		1,339,669
Deferred debt issue costs			303,073	1,557,466	4,305,203		6,165,742
Total noncurrent assets	<u>218,284,614</u>	<u>216,171,295</u>	<u>124,218,546</u>	<u>146,136,848</u>	<u>261,707,289</u>	<u>-</u>	<u>966,518,592</u>
<b>TOTAL</b>	<u>\$ 380,801,395</u>	<u>\$ 550,410,079</u>	<u>\$ 124,783,732</u>	<u>\$ 146,771,221</u>	<u>\$ 342,056,950</u>	<u>\$(170,883)</u>	<u>\$1,544,652,494</u>

See accompanying notes to basic financial statements.

(Continued)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**BALANCE SHEET — ENTERPRISE FUNDS**  
**AS OF JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Eliminations	Total
<b>LIABILITIES AND NET ASSETS</b>							
<b>CURRENT LIABILITIES:</b>							
Current liabilities payable from unrestricted assets:							
Accounts payable and accrued liabilities	\$ 9,361,122	\$ -		\$ -	\$ -	\$ -	\$ 9,361,122
Due to other funds	25,426		7,950		157,451	(170,883)	19,944
Accrued interest payable	413						413
Total current liabilities payable from unrestricted assets	<u>9,386,961</u>	<u>-</u>	<u>7,950</u>	<u>-</u>	<u>157,451</u>	<u>(170,883)</u>	<u>9,381,479</u>
Current liabilities payable from restricted assets:							
Accrued interest payable			494,330	15,882	930,333		1,440,545
Accounts payable and accrued liabilities		75,000	14,543	18,000	21,366,335		21,473,878
Bonds, notes and mortgage-backed certificates payable		42,530,000	2,245,000	18,350,173	4,480,000		67,605,173
Total current liabilities payable from restricted assets	<u>-</u>	<u>42,605,000</u>	<u>2,753,873</u>	<u>18,384,055</u>	<u>26,776,668</u>	<u>-</u>	<u>90,519,596</u>
Total current liabilities	<u>9,386,961</u>	<u>42,605,000</u>	<u>2,761,823</u>	<u>18,384,055</u>	<u>26,934,119</u>	<u>(170,883)</u>	<u>99,901,075</u>
<b>NONCURRENT LIABILITIES:</b>							
Noncurrent liabilities payable from unrestricted assets — Notes payable to Government Development Bank for Puerto Rico							
	3,495,586						3,495,586
Noncurrent liabilities payable from restricted assets:							
Allowance for losses on mortgage loan insurance					346,330		346,330
Bonds, notes and mortgage-backed certificates payable		393,881,052	105,050,000	89,494,999	217,247,626		805,673,677
Total noncurrent liabilities payable from restricted assets	<u>-</u>	<u>393,881,052</u>	<u>105,050,000</u>	<u>89,494,999</u>	<u>217,593,956</u>	<u>-</u>	<u>806,020,007</u>
Total noncurrent liabilities	<u>3,495,586</u>	<u>393,881,052</u>	<u>105,050,000</u>	<u>89,494,999</u>	<u>217,593,956</u>	<u>-</u>	<u>809,515,593</u>
Total liabilities	<u>12,882,547</u>	<u>436,486,052</u>	<u>107,811,823</u>	<u>107,879,054</u>	<u>244,528,075</u>	<u>(170,883)</u>	<u>909,416,668</u>
<b>NET ASSETS:</b>							
Invested in capital assets	3,601,354						3,601,354
Restricted for:							
Mortgage loan insurance					61,898,797		61,898,797
Affordable housing programs	29,500,000	113,924,027	16,979,859	38,892,167	31,599,354		230,895,407
Other housing programs					4,182,693		4,182,693
Unrestricted net assets (deficit)	<u>334,817,494</u>		<u>(7,950)</u>		<u>(151,969)</u>		<u>334,657,575</u>
Total net assets	<u>367,918,848</u>	<u>113,924,027</u>	<u>16,971,909</u>	<u>38,892,167</u>	<u>97,528,875</u>	<u>-</u>	<u>635,235,826</u>
<b>TOTAL</b>	<u>\$ 380,801,395</u>	<u>\$ 550,410,079</u>	<u>\$ 124,783,732</u>	<u>\$ 146,771,221</u>	<u>\$ 342,056,950</u>	<u>\$ (170,883)</u>	<u>\$ 1,544,652,494</u>

See accompanying notes to basic financial statements.

(Concluded)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS — ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single-Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Total
<b>OPERATING REVENUES:</b>						
Investment income:						
Interest income on deposits placed with banks	\$ 1,458,325	\$23,237,352	\$ 91	\$ -	\$ 607,114	\$ 25,302,882
Interest income on investments and investment contracts	1,506,973	16,133,178	6,618,440	8,383,373	12,499,277	45,141,241
Net increase in fair value of investments	8,096	943,869	5,069,631	5,247,258	9,558,910	20,827,764
Total investment income	2,973,394	40,314,399	11,688,162	13,630,631	22,665,301	91,271,887
Interest income on loans	12,663,266	369,308			108,633	13,141,207
Total investment income and interest income on loans	15,636,660	40,683,707	11,688,162	13,630,631	22,773,934	104,413,094
Noninterest income:						
Fiscal agency fees	98,321					98,321
Commitment, guarantee, service, and administrative fees	7,422,959				151,329	7,574,288
Mortgage loan insurance premiums					3,156,393	3,156,393
Other income	271,319				13,565	284,884
Total noninterest income	7,792,599				3,321,287	11,113,886
Total operating revenues	23,429,259	40,683,707	11,688,162	13,630,631	26,095,221	115,526,980
<b>OPERATING EXPENSES:</b>						
Provision for loan losses	9,523,192				478,079	10,001,271
Interest expense — Bonds, notes and mortgage-backed certificates payable	137,457	32,469,646	6,613,567	7,344,500	15,853,947	62,419,117

See accompanying notes to basic financial statements.

(Continued)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS — ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single-Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Total
Other noninterest expenses:						
Salaries and fringe benefits	10,778,163					10,778,163
Occupancy and equipment costs	2,391,645					2,391,645
Depreciation and amortization	1,169,109					1,169,109
Legal and professional fees	1,950,277				99,322	2,049,599
Office and administrative	526,062		98,320			624,382
Subsidy and trustee fees	3,911,775	150,000	25,041	71,074	101,623	4,259,513
Provision for losses on mortgage loan insurance					157,678	157,678
Other	1,158,067				948,628	2,106,695
Total noninterest expense	<u>21,885,098</u>	<u>150,000</u>	<u>123,361</u>	<u>71,074</u>	<u>1,307,251</u>	<u>23,536,784</u>
Total operating expenses	<u>31,545,747</u>	<u>32,619,646</u>	<u>6,736,928</u>	<u>7,415,574</u>	<u>17,639,277</u>	<u>95,957,172</u>
OPERATING INCOME (LOSS)	<u>(8,116,488)</u>	<u>8,064,061</u>	<u>4,951,234</u>	<u>6,215,057</u>	<u>8,455,944</u>	<u>19,569,808</u>
NONOPERATING REVENUES (EXPENSES):						
Contributions from Commonwealth of Puerto Rico	29,500,000				4,500,000	34,000,000
Contributions to others	(195,826)					(195,826)
Total nonoperating revenues — net	<u>29,304,174</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,500,000</u>	<u>33,804,174</u>
TRANSFERS IN	<u>32,291,848</u>	<u>-</u>	<u>492,404</u>	<u>53,075</u>	<u>4,536,242</u>	<u>37,373,569</u>
TRANSFERS OUT	<u>(30,636,592)</u>	<u>-</u>	<u>-</u>	<u>(1,706,218)</u>	<u>(128,597)</u>	<u>(32,471,407)</u>
CHANGE IN NET ASSETS	22,842,942	8,064,061	5,443,638	4,561,914	17,363,589	58,276,144
NET ASSETS — Beginning of year	<u>345,075,906</u>	<u>105,859,966</u>	<u>11,528,271</u>	<u>34,330,253</u>	<u>80,165,286</u>	<u>576,959,682</u>
NET ASSETS — End of year	<u>\$ 367,918,848</u>	<u>\$ 113,924,027</u>	<u>\$ 16,971,909</u>	<u>\$ 38,892,167</u>	<u>\$ 97,528,875</u>	<u>\$635,235,826</u>

See accompanying notes to basic financial statements.

(Concluded)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**STATEMENT OF CASH FLOWS — ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single-Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>						
Cash received from interest on housing program loans	\$ 11,012,610	\$ 387,108	\$ -	\$ -	\$ 43,775	\$ 11,443,493
Cash paid for housing program loans originated	(26,012,630)				(10,000)	(26,022,630)
Principal collected on housing program loans	23,568,726	2,611,353			10,000	26,190,079
Cash received from other operating noninterest income	8,259,733				229,280	8,489,013
Cash received from mortgage loan insurance premiums					3,156,393	3,156,393
Cash paid for other operating noninterest expenses	(10,027,841)	(150,000)	(132,051)	(53,075)	(287,104)	(10,650,071)
Cash payments for salaries and fringe benefits	(10,297,515)	(326)				(10,297,841)
Internal balances	6,689,974		7,950		(1,536,224)	5,161,700
Net cash provided by (used in) operating activities	<u>3,193,057</u>	<u>2,848,135</u>	<u>(124,101)</u>	<u>(53,075)</u>	<u>1,606,120</u>	<u>7,470,136</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>						
Contributions from Commonwealth of Puerto Rico	29,500,000				4,500,000	34,000,000
Contributions to others	(195,826)					(195,826)
Proceeds from issuance of notes payable	2,785,259				7,650,000	10,435,259
Payments of notes, bonds, and mortgage-backed certificates payable	(886,678)	(43,060,000)	(11,995,000)	(11,822,523)	(199,805,000)	(267,569,201)
Payment of debt issue costs					(166,500)	(166,500)
Interest paid	(154,753)	(375,733)	(6,495,099)	(6,044,355)	(15,891,858)	(28,961,798)
Transfers in	13,367,493		492,404	53,075	4,536,242	18,449,214
Transfers out	(30,636,590)			(1,706,218)	(128,597)	(32,471,405)
Net cash used in noncapital financing activities	<u>13,778,905</u>	<u>(43,435,733)</u>	<u>(17,997,695)</u>	<u>(19,520,021)</u>	<u>(199,305,713)</u>	<u>(266,480,257)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES — Acquisition of capital assets</b>						
	<u>(611,667)</u>					<u>(611,667)</u>

See accompanying notes to basic financial statements.

(Continued)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
(A Component Unit of Government Development Bank for Puerto Rico)

**STATEMENT OF CASH FLOWS — ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single-Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Total
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>						
Purchases of investments	(144,288)	(11,393,996)	(18,225,067)	(18,051,363)	(31,243,698)	(79,058,412)
Proceeds from redemptions of investments	305,567	17,961,158	29,675,436	29,178,462	231,219,590	308,340,213
Net increase in deposits placed with banks	(21,531,211)	(4,374,705)	(699)		(6,051,132)	(31,957,747)
Fees collected on other than housing program loans					6,927,998	6,927,998
Cash received from interest on investments	3,257,596	28,346,643	6,672,126	8,445,997	13,259,131	59,981,493
Proceeds from sales of real estate available for sale	1,256,872				958,789	2,215,661
Disbursement for acquisition of real estate available for sale					(297,445)	(297,445)
Net cash provided by (used in) investing activities	<u>(16,855,464)</u>	<u>30,539,100</u>	<u>18,121,796</u>	<u>19,573,096</u>	<u>214,773,233</u>	<u>266,151,761</u>
<b>NET CHANGE IN CASH</b>	(495,169)	(10,048,498)	-	-	17,073,640	6,529,973
CASH — Beginning of year	<u>7,227,598</u>	<u>17,767,124</u>			<u>130,148</u>	<u>25,124,870</u>
CASH — End of year	<u>\$ 6,732,429</u>	<u>\$ 7,718,626</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17,203,788</u>	<u>\$ 31,654,843</u>
<b>RECONCILIATION TO ENTERPRISE FUNDS BALANCE SHEET:</b>						
Cash — unrestricted	\$ 6,732,429	\$ -	\$ -	\$ -	\$ -	\$ 6,732,429
Cash — restricted		7,718,626			17,203,788	24,922,414
<b>TOTAL CASH AT YEAR END</b>	<u>\$ 6,732,429</u>	<u>\$ 7,718,626</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17,203,788</u>	<u>\$ 31,654,843</u>

See accompanying notes to basic financial statements.

(Continued)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**STATEMENT OF CASH FLOWS — ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single-Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Total
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:						
Operating income (loss)	\$ (8,116,488)	\$ 8,064,061	\$ 4,951,234	\$ 6,215,057	\$ 8,455,944	\$ 19,569,808
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:						
Depreciation and amortization	1,169,109					1,169,109
Accretion of deferred loan fees	(85,229)				(108,633)	(193,862)
Net increase in fair value of investments	(8,096)	(943,869)	(5,069,631)	(5,247,258)	(9,558,910)	(20,827,764)
Interest income on investments and investment contracts and deposits placed with banks	(2,965,298)	(39,370,530)	(6,618,531)	(8,383,373)	(13,106,391)	(70,444,123)
Capitalized interest on housing program loans	(1,607,039)					(1,607,039)
Provision for loan losses	9,523,192				478,079	10,001,271
Provision for losses on other assets	172,848					172,848
Provision for losses on mortgage loan insurance					157,678	157,678
Loss (gain) on sales of real estate available for sale	205,750				(23,906)	181,844
Provision for losses on real estate available for sale	352,515				925,185	1,277,700
Interest expense	137,457	32,469,646	6,613,567	7,344,500	15,853,947	62,419,117
Origination of housing program loans	(26,012,630)				(10,000)	(26,022,630)
Collections of housing program loans	23,568,726	2,611,353			10,000	26,190,079
Changes in operating assets and liabilities:						
Accrued interest on housing program loans	(52,337)	17,800				(34,537)
Other accounts receivable	504,746				(146,202)	358,544
Accounts payable and accrued liabilities	(284,143)	(326)	(8,690)	17,999	215,553	(59,607)
Internal balances	6,689,974		7,950		(1,536,224)	5,161,700
Net cash provided by (used in) operating activities	<u>\$ 3,193,057</u>	<u>\$ 2,848,135</u>	<u>\$ (124,101)</u>	<u>\$ (53,075)</u>	<u>\$ 1,606,120</u>	<u>\$ 7,470,136</u>

See accompanying notes to basic financial statements.

(Continued)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**STATEMENT OF CASH FLOWS — ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Operating and Administrative	Mortgage Trust III	Single-Family Mortgage Revenue Bonds Portfolio IX	Mortgage- Backed Certificates 2006 Series A	Other Nonmajor	Total
<b>NONCASH INVESTING AND NONCAPITAL FINANCING ACTIVITIES:</b>						
Capitalized interest on housing program loans	\$ 1,607,039	\$ -	\$ -	\$ -	\$ -	\$ 1,607,039
Loans receivable originated not yet disbursed					20,655,000	
Transfer of loans receivable to real estate available for sale	2,045,741			-	-	2,045,741
Accretion of discount on investments and investment contracts		11,472,774		-		11,472,774
Accretion of discount on bonds payable		32,469,646		743,998	102,626	33,316,270
Amortization of deferred loss on refunding (included in interest expense)				402,945	-	402,945
Increase in fair value of investments	8,096	943,869	5,069,631	5,247,258	9,558,910	20,827,764
Amortization of debt issue costs (included in interest expense)			171,669	154,785	716,510	1,042,964
Transfers from governmental funds to enterprise funds:						
Real estate available for sale	1,611,041					1,611,041
Due from/to governmental funds	(1,611,041)					(1,611,041)
Investments and investment contracts	881,567					881,567
Deposits placed with banks	17,649,392					17,649,392
Interest receivable	43,503					43,503
Real estate available for sale	350,424					350,424
Accounts payable and accrued liabilities	(500)					(500)
Transfer in from other fund	(18,924,351)					(18,924,351)
Transfer of internal balance	(35)					(35)

See accompanying notes to basic financial statements.

(Concluded)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**NOTES TO BASIC FINANCIAL STATEMENTS**  
**AS OF AND FOR THE YEAR ENDED JUNE 30, 2010**

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**1. REPORTING ENTITY**

Puerto Rico Housing Finance Authority (the "Authority") is a component unit of Government Development Bank for Puerto Rico ("GDB" or the "Bank"), which is a component unit of the Commonwealth of Puerto Rico (the "Commonwealth"). The Authority was created in 1977 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 federally insured mortgage loans on properties located in Puerto Rico and purchased by low- and moderate-income families. The Authority is authorized by the U.S. Department of Housing and Urban Development to administer the U.S. Housing Act Section 8 program in Puerto Rico 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, in conjunction with the Puerto Rico Department of Housing (the "Department of Housing"), is the entity responsible for certifying projects under the New Secure Housing Program (known in Spanish as *Nuevo Hogar Seguro*) with the approval of the Federal Emergency Management Agency (FEMA). This program is directed to plan, coordinate, and develop the construction of new housing as a replacement to those destroyed by Hurricane Georges in 1998, and to attend the housing needs of families living in hazard-prone areas.

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.

**2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting and reporting policies of the Authority conform to accounting principles generally accepted in the United States of America (U.S. GAAP), as applicable to governmental entities. The Authority follows Governmental Accounting Standards Board (GASB) pronouncements under the hierarchy established by GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, in the preparation of its financial statements. The Authority has elected to apply all applicable statements and interpretations issued by the Financial Accounting Standards Board after November 30, 1989, in accounting and reporting for its enterprise funds and business-type activities to the extent they do not conflict with GASB pronouncements.

The preparation of financial statements in conformity with U.S. 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 during the reported period. Actual results could differ from those estimates.

## **Government-Wide and Fund Financial Statements**

*Government-Wide Financial Statements* — The statement of net assets 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 assets, except for the residual amounts due between governmental and business-type activities. Interfund charges for services 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 assets (deficiency) presents the Authority's assets and liabilities, with the difference reported as net assets. Net assets (deficiency) are reported in three categories:

- Invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any.
- Restricted net assets result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net assets (deficit) consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have 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 enterprise funds.

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

## **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 funds 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 and Commonwealth funds to be received by the Housing and Urban Development (HUD) Programs, ARRA Funds, and Closing Costs Assistance Program. Other revenues are considered to be measurable and available only when cash is received. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

Modifications to the accrual basis of accounting include:

- Employees' vested annual leave is recorded as expenditure when utilized. The amount of accumulated annual leave unpaid at June 30, 2010, is reported only in the government-wide financial statements.
- Interest on general long-term obligations is generally recognized when paid.
- Debt service principal expenditures and claims and judgments are recorded only when payment is due.

*Governmental Funds* — The following governmental activities of the Authority are classified 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.

**ARRA Programs** — This special revenue fund accounts for funds received under Title XII and Section 1602 of the American Recovery and Reinvestment Act of 2009. Title XII is a grant program that provides funds for capital investments in Low-Income Housing Tax Credit projects. Section 1602 grants funds to states to finance construction or acquisition and rehabilitation of qualified low-income building for low-income housing in lieu of low-income housing tax credits.

**Closing Costs Assistance Program** — This program was created to provide subsidy to certain families to cover closing fees related to the purchase of housing units, subject to certain maximum amounts.

The following governmental activities of the Authority are accounted for in other nonmajor governmental funds:

**Affordable Housing Mortgage Subsidy Programs (AHMSP) (Stages 2, 3, 6, 7, 8, 9, 10, and 11)** — These special revenue funds are used to account for the proceeds of specific revenue sources under Stages 2, 3, 6, 7, 8, 9, 10, and 11 of the AHMSP that are legally restricted for expenditures to promote the origination of mortgage loans by financial institutions in the private sector to low- and moderate-income families. Under these stages, the Authority commits to provide subsidy for the down payment and/or the principal and interest payments on mortgage loans originated under a predetermined schedule of originations and, in the case of Stages 9, 10, and 11, to acquire such mortgages in the form of mortgage-backed securities issued by the financial institutions. Loans originated, as well as servicing, are kept by the originating financial institution. There was no open schedule of originations under these stages as of June 30, 2010.

**AHMSP Mortgage-Backed Certificates** — This special revenue fund is used to account for specific revenue sources used to provide subsidy for the mortgages underlying the mortgage-backed securities held as collateral for the mortgage-backed certificates issued in fiscal year 2007.

**AHMSP Act No. 124** — This special revenue fund accounts for excess subsidy funds, as well as accumulated net assets released periodically from arbitrage structures used to provide housing assistance.

**Special Obligation Refunding Bonds — Debt Service** — This debt service fund accounts for the funds and assets transferred by the Commonwealth through legislative appropriations and by the liquidator of the former Corporación de Renovación Urbana y Vivienda (CRUV). On August 21, 2009, the Authority's board of directors authorized to liquidate this fund and its net assets were transferred to the AHMSP Stage 7 fund to partially repay the amounts due GDB.

**New Secure Housing Program** — This special revenue fund is used to account for 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 the housing needs of those families living in hazard-prone areas.

**The Key for your Home Program**— This special revenue fund was created to provide subsidy to low and moderate income families of cost directly related to the purchase and rehabilitation of housing units, subject to certain maximum amounts. The fund was closed during the year ended June 30, 2010.

*Enterprise Funds' Financial Statements* — The financial statements of the enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

Enterprise funds distinguish 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.

*Enterprise Funds* — The following business-type activities of the Authority are classified as major enterprise funds:

**Operating and Administrative** — The Operating and Administrative fund accounts for lending and guarantee activities, except those accounted for in other enterprise funds, and most of the general and administrative activities of the Authority.

**Mortgage Trust III** — This fund is used to account for the financing of low- and moderate-income families' purchase of residential housing from the proceeds of bond issuances.

**Single-Family Mortgage Revenue Bonds Portfolio IX** — This fund is part of the Authority's AHMSP and are used to account for bond issuances, the proceeds of which are mainly used to purchase mortgage-backed securities collateralized by loans originated to finance low- and moderate-income families' purchase of residential housing units.

**Mortgage-Backed Certificates 2006 Series A** — This fund is used to account for the proceeds received in connection with 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 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 schedule 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.

The following business-type activities of the Authority are accounted for in other nonmajor enterprise funds:

**Mortgage Loan Insurance** — The mortgage loan insurance program was created by law 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 loan 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.

During the year ended June 30, 2008, the Authority created the Puerto Rico Housing Administration program, known in Spanish as “FHA Boricua,” expanding requirements and parameters under the existing Act No. 87, *Mortgage Loan Insurance*. 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 will be financed through annual insurance premiums, commitment and transaction fees, and proceeds from any sale of foreclosed real estate. The program also requires participants to comply with various eligibility requirements.

The Commonwealth guarantees up to \$75 million of the principal insured by the mortgage loan insurance program. As of June 30, 2010, the mortgage loan insurance program covered loans aggregating to approximately \$621 million.

**Land Acquisition and Construction Loans Insurance (Act No. 89)** — The land acquisition and construction loans insurance program provides mortgage credit insurance to low- and moderate-income families for the purchase of 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.

**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.

**Single-Family Mortgage Revenue Bonds Portfolio X and XI** — These funds are part of the Authority’s AHMSP and are used to account for bond issuances, the proceeds of which are mainly used to purchase mortgage-backed securities collateralized by loans originated to finance low- and moderate-income families’ purchase of residential housing units. On October 2009, Portfolio XI had an early redemption of its outstanding bonds for the amount of \$164 million.

**Homeownership Mortgage Revenue Bonds** — This fund is used to account for the proceeds of bond issuances to finance the acquisition of GNMA certificates backed by mortgage loans originated by eligible institutions to finance the purchase of qualified single-family residential housing.

**Home Ownership Mortgage Revenue Bonds (Series 2001)** — This fund is used to account for the proceeds of bond issuances to finance the acquisition of GNMA certificates backed by mortgage loans originated by eligible institutions to finance the purchase of single family residential housing.

**Home Ownership Mortgage Revenue Bonds (Series 2003)** — This fund is used to account for subsidies provided to low- and moderate-income families in obtaining a mortgage loan.

**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. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers. 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.

**Loans Receivable and Allowance for Loan Losses** — Loans in the enterprise funds 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 collectibility is uncertain, generally once a loan is 180 days past due. 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.

**Interfund Balances** — Interfund receivables and payables have been eliminated from the statement of net assets, except for the residual amounts due between governmental and business-type activities.

**Debt Issue Costs** — Debt issue costs are deferred, and amortized, as a component of interest expense, over the term of the related debt, using systematic and rational methods that approximate the interest method. Issuance costs of the bonds accounted for in the governmental funds are recorded as expenditures when paid.

**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 expenditure/expense. Gain or loss on sale related to foreclosed real estate available for sale are included within noninterest income in the accompanying statement of revenues, expenses, and changes in net assets.

**Capital Assets** — Capital assets, which include leasehold improvements, information systems, office furniture, equipment, and vehicles, are reported in the business-type activities column in the government-wide financial statements. 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 assets are valued at historical cost. Donated fixed assets are recorded at their fair market value at the date of donation. 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	5 years
Information systems	3 years
Vehicles	5 years

**Compensated Absences** — The employees of the Authority are granted 30 days of vacation and 18 days of sick leave annually. In the event of employee resignation, an employee is reimbursed for accumulated vacation days up to the maximum allowed. The enterprise fund financial statements and the government-wide financial statements present the cost of accumulated vacation and sick leave as a liability. There are no employees paid by governmental funds.

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

**Refundings** — Refundings involve the issuance of new debt whose proceeds are used to repay immediately (current refunding) or at a future time (advance refunding) previously issued debt. The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is recorded as an addition to or deduction from the new debt.

**No-Commitment Debt** — The Authority has issued notes and bonds in connection with the financing of low- and moderate-income housing projects. Certain of the obligations issued by the Authority are considered no-commitment debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements. The Authority and the Commonwealth, except for the assets held in trust and earnings thereon, are not liable directly or indirectly for the payment of such obligations.

Certain other collateralized obligations of the Authority are included in the accompanying basic financial statements because either they represent general obligations of the Authority or it maintains effective control over the assets transferred as collateral.

**Governmental Funds — Reservations of Fund Balance** — The governmental fund financial statements present reservations of fund balance for portions of fund balances that are legally segregated for a specific future use or are not available for other future spending.

**Loan Origination Costs and Commitment Fees** — GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Issues*, requires that loan origination and commitment fees and direct origination costs be amortized over the contractual life of the related loan. The Authority generally recognizes commitment fees as income when collected and the related loan origination costs as expense when incurred. Effective July 1, 2006, the Authority defers and amortizes

loan origination fees for certain single-family mortgage loans over the contractual life of such loans. In the opinion of management, the difference between the two methods does not have a significant effect on the Authority's financial position and changes in financial position.

**Transfers of Receivables** — Transfers and 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.

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.

**Mortgage Loan Insurance Premiums** — Premiums on insured mortgage loans are recognized as earned.

**Future Adoption of Accounting Pronouncements** — The GASB has issued the following statements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Type Fund Definitions*, which is effective for periods beginning after June 15, 2010.
- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employers Plans*, which is effective for periods beginning after June 15, 2011.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which is effective for periods beginning after June 15, 2010.

Management is evaluating the impact that these statements will have on the Authority's basic financial statements.

### **3. CASH AND DUE FROM BANKS, DEPOSITS PLACED WITH BANKS**

The table presented below discloses the level of custodial credit risk assumed by the Authority at June 30, 2010. Custodial credit risk is the risk that in the event of a financial institution 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 Development Bank (EDB) for Puerto Rico, a component unit of the Commonwealth, are not covered by this Commonwealth's 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. Maturities of deposits placed with banks at June 30, 2010, are as follows: \$388,966,050 in July 2010, \$19,639,984 in August 2010, \$42,993,993 in September 2010, \$22,204,236 in October 2010, \$41,491,751 in November 2010, and \$14,191,466 in December 2010.

As of June 30, 2010, \$556,497,861 of the depository bank balance of \$568,653,207 was uninsured and uncollateralized as follows:

	Carrying Amount	Depository Bank Balance	Amount Uninsured and Uncollateralized
Cash	\$ 38,523,063	\$ 39,165,727	\$ 29,297,125
Deposits placed with banks	<u>529,487,480</u>	<u>529,487,480</u>	<u>527,200,736</u>
Total	<u>\$ 568,010,543</u>	<u>\$ 568,653,207</u>	<u>\$ 556,497,861</u>

Uninsured and uncollateralized cash of approximately \$29.3 million at June 30, 2010, represents the bank balance of cash deposited at GDB. These deposits are exempt from the collateral requirement established by the Commonwealth. In addition, uninsured and uncollateralized deposits placed with banks consist of certificates of deposit issued by GDB and EDB amounting to \$527,200,736.

Reconciliation to the government-wide statement of net assets as of June 30, 2010, is as follows:

Unrestricted:		
Cash		\$ 6,732,429
Deposits placed with banks		<u>116,131,209</u>
Total unrestricted		<u>122,863,638</u>
Restricted:		
Cash		31,790,634
Deposits placed with banks		<u>413,356,271</u>
Total restricted		<u>445,146,905</u>
Total		<u>\$ 568,010,543</u>

#### 4. INVESTMENTS

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 Authority's board of directors. These investment policies also provide that purchases and sales of investment securities shall be made using the delivery versus payment method. The Authority does not have a formal policy for interest rate risk management.

The following table summarizes the type and maturities of investments held by the Authority at June 30, 2010. 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.

	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	Total
Government National Mortgage Association (GNMA)	\$ -	\$ 3,542,684	\$ 3,245,920	\$ 479,570,425	\$ 486,359,029
Federal National Mortgage Association (FNMA)			72,331	13,704,616	13,776,947
Federal Home Loan Mortgage Corporation (FHLMC)			22,883	14,751,674	14,774,557
Fixed-income external investment pool — Federated Government Obligations	25,062,978				25,062,978
Puerto Rico Housing Bank Portfolio II bonds				4,902,659	4,902,659
Nonparticipating investment contracts:					
GDB				196,904,000	196,904,000
Other			17,628,800	92,983,332	110,612,132
<b>Total</b>	<b><u>\$ 25,062,978</u></b>	<b><u>\$ 3,542,684</u></b>	<b><u>\$ 20,969,934</u></b>	<b><u>\$ 802,816,706</u></b>	<b><u>\$ 852,392,302</u></b>

Reconciliation to the government-wide statement of net assets as of June 30, 2010, is as follows:

Unrestricted investments and investment contracts	\$ 18,357,183
Restricted investments and investment contracts	<u>834,035,119</u>
<b>Total</b>	<b><u>\$ 852,392,302</u></b>

At June 30, 2010, 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 early repaid.

Investments in fixed-income external investment pools had an average maturity of less than 60 days; accordingly, they are presented as investments with maturities of less than one year.

All of the Authority's investments in mortgage-backed securities guaranteed by GNMA carry the explicit 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, as of June 30, 2010, are as follows:

Securities Type	Credit Risk Rating	
	AAA to A-	BBB
Mortgage-backed securities:		
FNMA	\$ 13,776,947	\$ -
FHLMC	14,774,557	
Fixed income external investment pool —		
Federated obligations	25,062,978	
Puerto Rico Housing Bank Portfolio II bonds	4,902,659	
Nonparticipating investment contracts	<u>96,706,005</u>	<u>210,810,127</u>
Total	<u>\$ 155,223,146</u>	<u>\$ 210,810,127</u>

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.

## 5. LOANS RECEIVABLE AND ALLOWANCE

Loans receivable as of June 30, 2010, consist of:

	Business-Type Activities			Total
	Operating and Administrative	Mortgage Trust III	Other Nonmajor	
Real estate loans — all types of residential property, bearing interest at various rates ranging from 5% to 18%	\$ 222,493,176	\$ 3,280,026	\$ 20,805,000	\$ 246,578,202
Less allowance for loan losses	(28,491,642)		(478,079)	(28,969,721)
Less deferred origination fees	<u>(2,654,351)</u>		<u>(6,819,367)</u>	<u>(9,473,718)</u>
Total	<u>\$ 191,347,183</u>	<u>\$ 3,280,026</u>	<u>\$ 13,507,554</u>	<u>\$ 208,134,763</u>

Reconciliation to the government-wide statement of net assets as of June 30, 2010, is as follows:

Unrestricted loans receivable — net	\$ 191,347,183
Restricted loans receivable — net	<u>16,787,580</u>
Total	<u>\$ 208,134,763</u>

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 2049. 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.

At June 30, 2010, nonperforming loans amounted to approximately \$62.6 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 \$2.1 million.

The Authority generally measures impairment of loans based upon the present value of a loan's expected future cash flows, except when foreclosure or liquidation is probable, or when the primary source of repayment is provided by real estate collateral. In these circumstances, impairment is measured based upon the fair value of the collateral less estimated selling and disposal costs. The present value of a loan's expected future cash flows is calculated using the loan's effective interest rate, based on the original contractual terms.

The loans considered impaired as of June 30, 2010, and the related interest income for the year then ended, are as follows:

Recorded investment in impaired loans:	
Requiring an allowance for loan losses	\$65,974,000
Not requiring an allowance for loan losses	<u>                    -</u>
 Total	 <u>\$65,974,000</u>
 Related allowance for loan losses	 \$27,232,000
Average recorded investment in impaired loans	56,109,000
Interest income recognized on impaired loans	-

The summary of the activity in the allowance for loan losses for the year ended June 30, 2010, is as follows:

	Governmental Activities	<u>Enterprise Fund</u>		Total
		Operating and Administrative	Other Nonmajor	
Balance — beginning of year	\$ 528,919	\$ 20,482,699	\$ -	\$ 21,011,618
Provision for loan losses		9,523,192	478,079	10,001,271
Transfer to enterprise funds	(528,919)	528,919		-
Net charge-offs		<u>(2,043,168)</u>		<u>(2,043,168)</u>
 Balance — end of year	 <u>\$ -</u>	 <u>\$ 28,491,642</u>	 <u>\$ 478,079</u>	 <u>\$ 28,969,721</u>

## **6. DUE FROM FEDERAL GOVERNMENT**

Under the New Secure Housing Program (the "Program"), the Authority is responsible for administering the Program, including contracting, supervising and paying the designers, inspectors, and legal services needed for the Program. The Authority also provides all the funding for the Program through a \$67 million non-revolving line of credit with GDB. The Department of Housing is responsible for land acquisitions, auctioning projects, 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, into new secure housing facilities was to be completed by December 31, 2007. In addition, FEMA would reimburse 75% of the allowable costs of the Program. Funds collected under the Program since its inception amounted to approximately \$113 million and are subject to compliance audits under OMB Circular A-133 and federal granting agencies audits.

In April 2007, FEMA discontinued reimbursing the Authority's allowable costs based on the Program's noncompliance with the scheduled dates for construction activities and case management. The Department of Housing requested a one-year extension up to December 31, 2008, and although original request was denied, FEMA granted such request in 2007.

On June 6, 2008, the Department of Housing requested an additional one-year extension up to December 31, 2009, for the completion of the construction and relocation of participants into new secure housing facilities. On July 1, 2008, FEMA denied the additional one-year extension. The Department of Housing requested through the Governor's Authorized Representative (GAR) on September 19, 2008, a reconsideration of FEMA's decision not to grant the extension. On December 23, 2008, FEMA granted a one-year extension up to June 30, 2010.

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 extension granted by FEMA. Based on this and the fact that no reimbursements have been received from FEMA since April 2007, management has decided to establish an allowance for the \$26 million due from FEMA.

In addition, on February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law in the United States of America. The purpose of ARRA is to jumpstart the nation's ailing economy, with the primary focus on creating and saving jobs in the near term and investing in infrastructure that will provide long-term economic benefits. The Authority expended \$86.6 million of ARRA program funds of which \$21.9 are due from the federal government at June 30, 2010.

## 7. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2010, was as follows:

	Beginning Balance	Additions	Reductions/ Reclassifications	Ending Balance
Capital assets:				
Leasehold improvements	\$ 3,966,034	\$ 15,909	\$ -	\$ 3,981,943
Information systems	1,506,439	573,672		2,080,111
Office furniture and equipment	2,081,349	22,086		2,103,435
Vehicles	<u>156,023</u>	<u>          </u>	<u>(6,000)</u>	<u>150,023</u>
Total capital assets	<u>7,709,845</u>	<u>611,667</u>	<u>(6,000)</u>	<u>8,315,512</u>
Less accumulated depreciation and amortization for:				
Leasehold improvements	(1,326,047)	(360,649)		(1,686,696)
Information systems	(834,020)	(428,247)		(1,262,267)
Office furniture and equipment	(1,281,861)	(366,150)		(1,648,011)
Vehicles	<u>(109,121)</u>	<u>(14,063)</u>	<u>6,000</u>	<u>(117,184)</u>
Total accumulated depreciation and amortization	<u>(3,551,049)</u>	<u>(1,169,109)</u>	<u>6,000</u>	<u>(4,714,158)</u>
Total capital assets — net	<u>\$ 4,158,796</u>	<u>\$ (557,442)</u>	<u>\$ -</u>	<u>\$ 3,601,354</u>

## 8. BONDS AND NOTES PAYABLE AND OTHER LIABILITIES

The activity of bonds and notes payable for the year ended June 30, 2010, is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Governmental activities:					
Commonwealth appropriation note payable — AHMSP Stage 7	\$ 4,811,237	\$ -	\$ -	\$ 4,811,237	\$ -
Due to GDB:					
AHMSP Stage 7	52,404,062		(13,108,142)	39,295,920	39,295,920
AHMSP Stage 9	340,458		(340,458)	-	
AHMSP Stage 10	13,580,319	14,261,235	(13,920,786)	13,920,768	
New Secure Housing Program	<u>43,515,774</u>	<u>7,314,700</u>	<u>(3,311,815)</u>	<u>47,518,659</u>	<u>2,817,193</u>
<b>Total governmental activities</b>	<b>\$ 114,651,850</b>	<b>\$21,575,935</b>	<b>\$ (30,681,201)</b>	<b>\$ 105,546,584</b>	<b>\$42,113,113</b>
Business-type activities:					
Mortgage Trust III	\$ 947,393,874	\$ -	\$ (43,060,000)	\$ 904,333,874	\$42,530,000
Mortgage-Backed Certificates — 2006 Series A	132,081,815		(11,822,523)	120,259,292	18,350,173
Revenue bonds:					
Single Family Mortgage Revenue Bonds — Portfolio IX	119,290,000		(11,995,000)	107,295,000	2,245,000
Single Family Mortgage Revenue Bonds — Portfolio X	80,030,000		(6,405,000)	73,625,000	1,255,000
Single Family Mortgage Revenue Bonds — Portfolio XI	200,000,000		(181,090,000)	18,910,000	300,000
Homeownership Mortgage Revenue Bonds 2000	52,420,000		(4,515,000)	47,905,000	1,085,000
Homeownership Mortgage Revenue Bonds 2001	55,610,000		(5,390,000)	50,220,000	1,250,000
Homeownership Mortgage Revenue Bonds 2003	<u>25,720,000</u>		<u>(2,405,000)</u>	<u>23,315,000</u>	<u>590,000</u>
<b>Total revenue bonds</b>	<b>533,070,000</b>	<b>-</b>	<b>(211,800,000)</b>	<b>321,270,000</b>	<b>6,725,000</b>
<b>Subtotal</b>	<b>1,612,545,689</b>	<b>-</b>	<b>(266,682,523)</b>	<b>1,345,863,166</b>	<b>67,605,173</b>
Notes payable:					
GDB (operating and administrative)	1,597,005	2,785,259	(886,678)	3,495,586	
Special obligation notes, 2010 Series A		15,000,000		15,000,000	
Plus unamortized premium	551,694		(53,441)	498,253	
Less unaccreted discount and deferred amount on refunded bonds	<u>(514,505,227)</u>	<u>(7,350,000)</u>	<u>33,772,658</u>	<u>(488,082,569)</u>	
<b>Total business-type activities</b>	<b>\$1,100,189,161</b>	<b>\$10,435,259</b>	<b>\$(233,849,984)</b>	<b>\$ 876,774,436</b>	<b>\$67,605,173</b>

The annual debt service requirements to maturity, including principal and interest, for long-term debt, other than amounts due to GDB as of June 30, 2010, are as follows:

Years Ending June 30	Governmental Activities		Business-Type Activities	
	Principal	Interest	Principal	Interest
2011	\$ -	\$ 256,831	\$ 67,605,173	\$ 22,289,497
2012		261,554	59,629,153	21,282,980
2013		201,452	58,391,987	20,465,843
2014	95,757	217,922	54,447,255	19,640,525
2015	89,306	215,785	51,253,319	19,867,668
2016-2020	562,166	962,436	250,489,120	86,826,494
2021-2025	454,477	760,689	118,022,754	64,732,625
2026-2030	2,491,101	532,381	599,163,299	41,650,242
2031-2035	1,118,430	20,719	84,731,106	13,125,445
2036-2040			17,130,000	1,675,624
Total	<u>\$4,811,237</u>	<u>\$3,429,769</u>	<u>\$1,360,863,166</u>	<u>\$311,556,943</u>

#### Governmental Activities

Notes payable by governmental activities, excluding amounts due to GDB, consist of the following:

Description and Maturity Date	Interest Rate	Amount Outstanding
Note Payable AHMSP Stage 7 — July 1, 2010, and each July 1 thereafter to July 1, 2031	4.1%-5.25%	<u>\$4,811,237</u>

**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 acquired and restructured the Note through the issuance of its Commonwealth appropriations bonds ("PFC Bonds"). The PFC Bonds were issued under a trust indenture whereby the Puerto Rico Public Finance Corporation 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 Puerto Rico Public Finance Corporation were originally composed of a loan granted by GDB, which, pursuant to Act No. 164 of December 17, 2001, the Puerto Rico Public Finance Corporation acquired and restructured through the issuance of Commonwealth appropriation bonds. These bonds were issued under trust indenture agreements whereby the Puerto Rico Public Finance Corporation 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.

During June 2004, the Puerto Rico Public Finance Corporation 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 recognizes a mirror effect of this advance refunding by the Puerto Rico Public Finance Corporation in its own notes payable in proportion to the portion of the Authority's notes payable included in the Puerto Rico Public Finance Corporation refunding. The aggregate debt service requirements of the refunding and unrefunded notes will be funded with annual appropriations from the Commonwealth.

The Note's outstanding balance at June 30, 2010, was \$4,811,237 and matures on July 1, 2031. Interest on the unpaid principal amount of the Note is equal to the applicable percentage of the aggregate interest payable on the Public Finance Corporation Bonds. Applicable percentage is the percentage representing the proportion of the amount paid by the Public Finance Corporation on the PFC Bonds serviced by the Note to the aggregate amount paid by the Public Finance Corporation on all the PFC Bonds issued by the Public Finance Corporation under Act No. 164.

**Due to GDB — New Secure Housing Program** — On May 19, 2008, the Authority restructured its New Secure Housing Program credit facility with GDB into a long-term nonrevolving line of credit. The restructured credit facility has a maximum credit limit of \$67 million and bears a variable interest consisting of the 60-day London Interbank Offered Rate, plus 1.25% (1.54% at June 30, 2010) payable on June 30 of each year until June 30, 2027.

### Business-Type Activities

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

Description and Maturity Date	Interest Rate	Amount Outstanding
Mortgage Trust III:		
Each July 1 and January 1 until July 1, 2011	Zero Coupon	\$ 38,940,796
Each July 1 and January 1 until January 1, 2021	Zero Coupon	246,640,811
January 1, 2026	Zero Coupon	150,829,446
Single Family Mortgage Revenue Bonds — Portfolio IX — Each December 1 and June 1 until December 1, 2012	3.85%–5.60%	107,295,000
Single Family Mortgage Revenue Bonds — Portfolio X — Each December 1 and June 1 until December 1, 2037	4.15%–5.65%	73,625,000
Single Family Mortgage Revenue Bonds — Portfolio XI — Each December 1 and June 1 until December 1, 2039	2.60%–5.45%	18,910,000
Homeownership Mortgage Revenue Bonds 2000 Series — Each June 1 and December 1 until December 1, 2032	4.25%–5.20%	47,905,000
Homeownership Mortgage Revenue Bonds 2001 Series: Each December 1 until December 1, 2012	4.50%–4.70%	3,930,000
June 1, 2013, and each December 1 and June 1 thereafter to December 1, 2033	4.45%–5.50%	46,290,000
Homeownership Mortgage Revenue Bonds 2003 Series: Each December 1 until December 1, 2013	3.55%–4.00%	2,485,000
June 1, 2013, and each December 1 and June 1 thereafter to December 1, 2033	4.375%–4.875%	20,830,000
Mortgage-Backed Certificates, 2006 Series A — principal and interest payable monthly from September 29, 2006 to August 29, 2030	2.955%–6.560%	107,845,171
Special Obligation Notes, 2010 Series A — May 1, 2040	6.974 %	<u>7,752,626</u>
Total		<u>\$ 873,278,850</u>

**Note Payable to GDB** — On October 7, 2008, the Authority entered in an agreement with GDB to create a credit facility to manage its co-participation program. Under this program, the Authority participates in conjunction with private banks in the granting of construction loans to developers that qualified under Act No. 124. The credit facility has a maximum credit limit of \$50 million, matures on October 7, 2014, and bears a variable interest consisting of Prime rate, plus 1% (4.25% at June 30, 2010).

**Special Obligation Notes, 2010 Series A** — On October 22, 2009, the Authority issued \$15,000,000 of Special Obligation Notes, 2010 Series A. These notes are collateralized by certain second mortgage originated under the Home Purchase Stimulus Program. The Notes will be repaid from collections of principal and interest of the underlying collateral, net of servicing and guarantee fees. The second mortgage loans are guaranteed by the Authority's Act No. 87 insurance.

**Compensated Absences** — The activity for compensated absences, included within accounts payable and accrued liabilities, during the year ended June 30, 2010, is as follows:

	<b>Beginning Balance</b>	<b>Provision</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Due Within One Year</b>
Vacation	\$ 684,823	\$ 744,284	\$ (799,444)	\$ 629,663	\$ 629,663
Sick leave	<u>537,791</u>	<u>446,571</u>	<u>(371,050)</u>	<u>613,312</u>	<u>613,312</u>
Total	<u>\$1,222,614</u>	<u>\$1,190,855</u>	<u>\$(1,170,494)</u>	<u>\$1,242,975</u>	<u>\$1,242,975</u>

Compensated absences are available to be liquidated by the employees during the year.

**9. RESTRICTED NET ASSETS — MORTGAGE LOAN INSURANCE FUND**

The Authority is required by law to maintain an allowance for estimated losses on insured mortgage loans, which is computed as a percentage of the outstanding principal balance of the insured mortgage loans. Losses incurred upon the foreclosure and subsequent gains or losses on the disposal of properties are credited/charged to the allowance for mortgage loan insurance. At June 30, 2010, the Authority had restricted net assets for such purposes of approximately \$61.9 million.

**10. RELATED-PARTY TRANSACTIONS**

A summary of the most significant related-party balances and transactions as of June 30, 2010, and for the year ended is as follows:

*Commonwealth of Puerto Rico* — Legislative appropriations of approximately \$45.2 million were received by the governmental and enterprise funds during the year ended June 30, 2010. These appropriations are restricted for the payment of certain bonds, to support low-income housing assistance programs, to fund loan originations under the co-participation program (see Note 8), and to fund loan originations under the Home Purchase Stimulus Program (see Notes 2 and 8).

*Department of Housing* — At June 30, 2010, the Authority has an amount due from the Department of Housing amounting to \$581,687. Management has fully reserved this balance as of June 30, 2010.

GDB — The Authority has the following related-party balances and transactions with GDB as of and for the year ended June 30, 2010:

	Carrying Amount	Interest Rate	Interest Income (Expense)
<b>Assets:</b>			
Cash — including accrued interest	\$ 28,648,765	Variable	\$ 16,260
Deposits placed with banks — including accrued interest	473,863,851	2.51%–7.25%	24,880,826
Nonparticipating investment contracts	146,301,027	Zero Coupon	11,404,444
Nonparticipating investment contracts — including accrued interest	<u>50,668,688</u>	4.50%–8.00%	<u>3,832,507</u>
<b>Total</b>	<b><u>\$699,482,331</u></b>		<b><u>\$ 40,134,037</u></b>
<b>Liabilities:</b>			
Lines of credit and notes payable — including accrued interest	\$ 104,231,346	1.51%–7.00%	\$ (2,287,735)
Bonds payable	<u>150,829,446</u>	Zero coupon	<u>(11,370,571)</u>
<b>Total</b>	<b><u>\$255,060,792</u></b>		<b><u>\$(13,658,306)</u></b>

*Lease Commitments* — The Authority entered into a 30-year lease agreement with the Puerto Rico Department of Housing (PRDH) 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 PRDH 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, 2010 amounted to \$1,500,000.

## 11. 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 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, 2010, commitments to extend credit amounted to approximately \$32,408,000.

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, 2010, there were no commitments outstanding to purchase mortgage-backed securities.

## 12. RETIREMENT SYSTEM

**Defined Benefit Pension Plan** — The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the "Retirement System"), created pursuant to Act No. 447 of May 15, 1951, as amended, is a cost-sharing, multiple-employer defined benefit pension plan sponsored by and reported as a component unit of the Commonwealth. All regular employees of the Authority hired before January 1, 2000, and less than 55 years of age at the date of employment became members of the Retirement System as a condition to their employment. No benefits are payable if the participant receives a refund of accumulated contributions.

The Retirement System provides retirement, death, and disability benefits pursuant to legislation enacted by the Commonwealth's Legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after 10 years of plan participation. Disability benefits are available to members for occupational and nonoccupational disabilities. However, a member must have at least 10 years of service to receive nonoccupational disability benefits.

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service, or members who have attained 58 years of age and have completed 10 years of creditable service, are entitled to an annual benefit payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65% of the average compensation, as defined; otherwise, they will receive 75% of the average compensation, as defined.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Authority is required by the same statute to contribute 9.275% of the participant's gross salary.

**Defined Contribution Plan** — The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amended Act No. 447 to establish, among other things, a defined contribution savings plan program (the "Savings Plan") to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000, and former employees who participated in the defined benefit pension plan, received a refund of their contributions, and were rehired on or after January 1, 2000, become members of the Program as a condition to their employment. In addition, employees who at December 31, 1999, were participants of the defined benefit pension plan had the option, up to March 31, 2000, to irrevocably transfer their contributions to the defined benefit pension plan, plus interest thereon to the Program.

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to individual accounts established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant's account semiannually.

The Authority is required by Act No. 305 to contribute 9.275% of the participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan.

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant's spouse in case of the participant's death. Participants with a balance of \$10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in the participant's account will be paid in a lump sum to any beneficiaries. Participants have the option of a lump-sum payment or purchase of an annuity contract in case of permanent disability.

Total employee contributions to the above-mentioned plans during the year ended June 30, 2010, amounted to approximately \$479,000. The Authority's contributions for the years ended June 30, 2010, 2009, and 2008, amounted to approximately \$538,000, \$579,000, and \$675,000, 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.

Additional information on the Retirement System is provided in its stand-alone financial statements for the year ended June 30, 2010, a copy of which can be obtained from the Commonwealth of Puerto Rico Government Employees and Judiciary Retirement Systems Administration, 437 Ponce de León Avenue, Hato Rey, Puerto Rico 00918.

### 13. 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 Enterprise Funds** — At June 30, 2010, the Authority was custodian of \$203,706 in restricted funds of CRUV. As of June 30, 2010, such funds were deposited with GDB. These funds are not owned by the Authority's enterprise funds 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, 2010, the aggregate outstanding principal balance of the loans pooled into the FNMA certificate amounted to \$598,044.

**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, 2010, the principal balance of the mortgage loans serviced for others is as follows:

Popular Mortgage, Inc.	\$ 84,586
R-G Mortgage, Inc.	1,495,591
CRUV or its successor without guaranteed mortgage loan payments	<u>43,771</u>
Total	<u>\$1,623,948</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.

**14. NO-COMMITMENT DEBT AND PROGRAMS SPONSORED BY THE AUTHORITY**

Certain bonds of the Authority are considered no-commitment debt as more fully described in Note 2. At June 30, 2010, there were restricted assets held in trust by others, outstanding obligations, fund balances, and excess of fund expenses over revenues, net of transfers (all of which are excluded from the accompanying basic financial statements), as indicated below (unaudited):

Restricted assets	\$6,321,592
Restricted liabilities (no-commitment debt)	<u>5,288,433</u>
Restricted fund balance	<u>\$ 1,033,159</u>
Excess of fund expenses over revenues	<u>\$ 175,429</u>

In addition, 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 \$360 million at June 30, 2010.

On August 1, 2008, the Housing Finance Authority issued the Capital Fund Modernization Program Subordinate Bonds amounting to \$384,475,000 and the Housing Revenue Bonds amounting to \$100,000,000. The proceeds from the issuance will be mainly used to finance a loan to a limited liability company and pay the costs of issuance. The \$384,475,000 bonds are limited obligations of the Authority, payable primarily by a pledge and assignment of federal housing assistance payments made available by the U.S. Department of Housing and Urban Development with an outstanding balance of \$356,270,000 at June 30, 2010. The \$100,000,000 bonds are also limited obligations of the Authority, payable from amounts deposited in escrow accounts with a trustee and the proceeds of a loan to be made by the Authority to the LLC using moneys received as a grant from the Puerto Rico Department of Housing. Payment of principal of the Housing Revenue Bonds is also secured by an irrevocable standby letter of credit issued by the Bank. These bonds are considered no-commitment debt and, accordingly, are excluded, along with the related assets held in trust, from the Authority's financial statements.

In addition, the Authority, as a public housing agency, is authorized to administer the U.S. Housing Act Section 8 Programs in Puerto Rico. The revenues and expenses of such federal financial assistance are accounted for as a major governmental fund under HUD Programs. Revenues and expenditures related to the administration of the U.S. Housing Act Section 8 Programs amounted to approximately \$124,560,000 for the year ended June 30, 2010. This amount includes approximately \$4,680,000 of administrative fees for services performed as contract administrator, which are reimbursed by HUD.

In addition, on February 17, 2009, the ARRA was signed into law in the United States of America. The purpose of ARRA is to jumpstart the nation's ailing economy, with a primary focus on creating and saving jobs in the near term and investing in infrastructure that will provide long-term economic benefits. The Authority expended \$86.6 million of ARRA program funds during the year ended June 30, 2010 of which \$21.9 million are due from the federal government at June 30, 2010.

On February 23, 2009, the Authority entered into an agreement with the Puerto Rico Department of Housing whereby a limited liability company was incorporated by the name of Puerto Rico Community Development Fund, LLC ("PRCDF"). PRCDF is a Community Development Entity ("CDE"). A CDE is any duly organized entity treated as a domestic corporation or partnership for federal income tax purposes that: (a) has a primary mission of serving, or providing investment capital for, low-income communities or low-income persons; (b) maintains accountability to residents of low-income communities through their representation on any governing board of the entity or any advisory board to the entity; and (c) has been certified as a CDE by the CDFI Fund of the U.S. Department of Treasury. On March 2, 2009, in order to carry its mission, the PRCDF requested New Markets Tax Credits ("NMTC"). The NMTC Program permits taxpayers to receive a credit against federal income taxes for making qualified equity investments in designated Community Development Entities. PRCDF is pending to receive the NMTC allocation.

## **15. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS**

For a significant portion of the Authority's financial instruments (principally loans), fair values are not readily available since there are no available trading markets. Accordingly, fair values can only be derived or estimated using valuation techniques, such as present-valuing estimated future cash flows using discount rates, which reflect the risk involved, and other related factors. Minor changes in assumptions or estimation methodologies may have a material effect on the results derived therein.

The fair values reflected below are indicative of the interest rate environment as of June 30, 2010, and do not take into consideration the effects of interest rate fluctuations. In different interest rate scenarios, fair value results can differ significantly. Furthermore, actual prepayments may vary significantly from those estimated resulting in materially different fair values.

The difference between the carrying value and the estimated fair value may not be realized, since, in many of the cases, the Authority intends to hold the financial instruments until maturity, or because the financial instruments are restricted. Comparability of fair values among financial institutions is not likely, due to the wide range of permitted valuation techniques and numerous estimates that must be made in the absence of secondary market prices.

The following methods and assumptions were used by the Authority in estimating fair values of the financial instruments for which it is practicable to estimate such values:

- Short-term financial instruments, such as cash, deposits placed with banks, due from federal government, due from Commonwealth, and accrued interest receivable and payable have been valued at the carrying amounts reflected in the statement of net assets, as these are reasonable estimates of fair value given the relatively short period of time between origination of the instruments and their expected realization.

- Financial instruments that are primarily traded in secondary markets, such as most investments, were valued using either quoted market prices or quotations received from independent broker dealers or pricing service organizations.
- Financial instruments that are not generally traded, such as investment contracts, and bonds and notes issued with fixed interest rates, were fair valued using the present values of estimated future cash flows at the appropriate discount rates. Bonds and notes issued with interest rates floating within certain ranges were fair valued at their outstanding principal balance.
- Loans and commitments to extend credit are generally granted for low-cost housing development projects. For these types of loans and commitments, there is no secondary market, and the actual future cash flows may vary significantly as compared to the cash flows projected under the agreements, due to the degree of risk. Accordingly, management has opted not to disclose the fair value of these financial instruments, as such information may not be estimated with reasonable precision.

The carrying amounts and estimated fair values of the Authority's financial instruments as of June 30, 2010, are as follows (in millions):

	<b>Carrying Amount</b>	<b>Fair Value</b>
Financial assets:		
Cash and due from banks	\$ 39	\$ 39
Deposits placed with banks	529	529
Investments and investment contracts	852	961
Accrued interest and other receivables	18	18
Due from federal government	23	23
Due from Commonwealth	5	5
Financial liabilities:		
Due to GDB	104	104
Accounts payable and accrued liabilities	78	78
Accrued interest payable	2	2
Bonds and notes payable	878	1,022

**16. INTERFUND BALANCES AND TRANSFERS**

The summary of the interfund balances as of June 30, 2010, between governmental funds and enterprise funds is as follows:

<b>Receivable By</b>	<b>Payable By</b>	<b>Purpose</b>	<b>Amount</b>
Enterprise funds: Operating and administrative	Governmental funds: Other nonmajor (New Secure Housing Program)	Debt service payments	\$ 54,117
Operating and administrative	Other nonmajor (AHMSP Stage 7)	Reimbursement of expenditures	817,842
Operating and administrative	Closing Costs Assistance Program	Reimbursement of expenditures	24,014
Operating and administrative	HUD Programs	Reimbursement of expenditures	<u>1,235,972</u>
Total			2,131,945
Governmental funds — Other nonmajor (New Secure Housing Program)	Enterprise funds — Operating and administrative	Reimbursement of expenditures	<u>(19,944)</u>
Total internal balances — net			<u>\$ 2,112,001</u>

The summary of the interfund balances as of June 30, 2010, between governmental funds is as follows:

<b>Receivable By</b>	<b>Payable By</b>	<b>Purpose</b>	<b>Amount</b>
Governmental fund — Other nonmajor (AHMSP Stage 7)	Governmental fund — Other nonmajor (AHMSP Stage 6)	Advance	<u>\$ 71</u>

The summary of the interfund balances as of June 30, 2010, between enterprise funds is as follows:

Receivable By	Payable By	Purpose	Amount
Enterprise fund:	Enterprise fund:		
Operating and administrative	Other nonmajor (Home Purchase Stimulus Program)	Reimbursement of loan origination	\$ 150,000
Operating and administrative	Single-Family Mortgage Revenue Bonds Portfolio IX	Agency fees	7,950
Operating and administrative	Other nonmajor (Homeownership Mortgage Revenue Bonds)	Agency fees	7,451
Other nonmajor (Mortgage Loan Insurance Program)	Operating and administrative	Agency fees	<u>5,482</u>
Total			<u>\$ 170,883</u>

The summary of interfund transfers for the year ended June 30, 2010, is as follows:

Transfer Out	Transfer In	Purpose	Amount
<b>Governmental funds:</b>	<b>Governmental funds:</b>		
Other nonmajor (Special Obligation Refunding Bonds — Debt Service)	Other nonmajor (AHMSP Stage 7)	Release of excess funds	\$ 31,436,410
Other nonmajor (The Key for Your Home)	Other nonmajor (AHMSP Act No. 124)	Release of excess funds	1,496,751
Other nonmajor (AHMSP Stage 10)	Other nonmajor (AHMSP Stage 9)	Release of excess funds	340,458
<b>Enterprise funds:</b>	<b>Governmental funds:</b>		
Operating and Administrative	Closing Costs Assistance Program	Contribution	21,167,689
Operating and Administrative	Other nonmajor (New Secure Housing Program)	Debt service payments	9,415,828
Mortgage-Backed Certificates 2006 Series A	Other nonmajor (AHMSP Mortgage-Backed Certificates)	Subsidy payments	1,706,218
Other nonmajor (Single-Family Mortgage Revenue Bonds Portfolio XI)	Other nonmajor (AHMSP Stage 11)	Release of excess funds	507
<b>Governmental funds:</b>	<b>Enterprise funds:</b>		
Other nonmajor (AHMSP Act No. 124)	Operating and Administrative	Release of excess funds	18,906,795
Other nonmajor (The Key for Your Home)	Operating and Administrative	Release of excess funds	13,385,053
Other nonmajor (AHMSP Stage 9)	Single-Family Mortgage Revenue Bonds Portfolio IX	Debt service payments	492,404
Other nonmajor (AHMSP Stage 10)	Other nonmajor (Single-Family Mortgage Revenue Bonds Portfolio X)	Debt service payments	223,593
Other nonmajor (AHMSP Stage 11)	Other nonmajor (Single-Family Mortgage Revenue Bonds Portfolio XI)	Debt service payments	4,184,559
<b>Enterprise fund:</b>	<b>Enterprise fund:</b>		
Other nonmajor (Homeownership Mortgage Revenue Bonds 2001)	Other nonmajor (Homeownership Mortgage Revenue Bonds 2003)	Debt service payments	128,090
Operating and administrative	Mortgage-Backed Certificates 2006 Series A	Agency fees	53,075

**17. FUND BALANCE DEFICIT**

The following governmental funds reflect a deficit fund balance at June 30, 2010: AHMSP Stage 7 and New Secure Housing Program for the amount of \$19.6 million and \$4.9 million, respectively. The deficit of the AHMSP Stage 7 is due to the amounts borrowed by the Authority from GDB that were used to provide housing subsidies. The deficit of the New Secure Housing Program is due to FEMA discontinued reimbursement of the Authority's allowable cost. The Authority expects to cover these deficits through contributions from the Commonwealth.

**18. SUBSEQUENT EVENTS**

**HOME Program** — Effective July 1, 2010, the Authority was certified by HUD to administer the HOME Investment Partnerships (HOME) Program. The objectives of the HOME Program include: (1) expanding the supply of decent and affordable housing, particularly housing for low- and very low-income americans; (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 and the private sector, including for-profit and nonprofit organizations, in the production and operation of affordable housing.

**Contribution From the Commonwealth** — In September 2010, the Commonwealth contributed \$36,776,000 to the Authority for housing subsidies under the Closing Costs Assistance Program.

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**PUERTO RICO HOUSING FINANCE AUTHORITY**  
(A Component Unit of Government Development Bank for Puerto Rico)

**COMBINING BALANCE SHEET INFORMATION — OTHER NONMAJOR GOVERNMENTAL FUNDS**  
**AS OF JUNE 30, 2010**

	AHMSF Stage 2	AHMSF Stage 3	AHMSF Stage 6	AHMSF Stage 7	AHMSF Stage 8	AHMSF Stage 9	AHMSF Stage 10	AHMSF Stage 11	AHMSF Mortgage- Backed Certificates	AHMSF Act No. 124	New Secure Housing Program	Total Other Nonmajor Governmental Funds
<b>ASSETS</b>												
DUE FROM OTHER FUNDS	\$ -	\$ -	\$ -	\$ 71	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 19,944	\$ 20,015
RESTRICTED:												
Cash	417	417	8,284	254,834	60,271					1,572,219	288,138	2,184,580
Deposits placed with banks										1,805		1,805
Accrued interest receivable	9,934	7,540	28,908	85,616	69,442	2,645	588	202	1,229	2,290	21	208,415
Investments and investment contracts	<u>8,440,211</u>	<u>5,929,920</u>	<u>11,234,330</u>	<u>21,680,078</u>	<u>15,739,986</u>	<u>11,757,356</u>	<u>5,499,702</u>	<u>24,502,105</u>	<u>3,633,680</u>	<u>577,782</u>		<u>108,995,150</u>
<b>TOTAL</b>	<u>\$8,450,562</u>	<u>\$5,937,877</u>	<u>\$11,271,522</u>	<u>\$22,020,599</u>	<u>\$15,869,699</u>	<u>\$11,760,001</u>	<u>\$5,500,290</u>	<u>\$24,502,307</u>	<u>\$3,634,909</u>	<u>\$2,154,096</u>	<u>\$308,103</u>	<u>\$111,409,965</u>
<b>LIABILITIES AND FUND BALANCES (DEFICIT)</b>												
LIABILITIES:												
Due to other funds	\$ -	\$ -	\$ 71	\$ 817,842	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 54,117	\$ 872,030
Payable from restricted assets:												
Accounts payable and accrued liabilities	401,705	14,417	366,312	1,469,078	511,937	304,559	70,791	139,885	2,853,791	32,980	5,135,905	11,301,360
Due to Government Development Bank for Puerto Rico				<u>39,295,920</u>								<u>39,295,920</u>
Total liabilities	401,705	14,417	366,383	41,582,840	511,937	304,559	70,791	139,885	2,853,791	32,980	5,190,022	51,469,310
FUND BALANCES (DEFICIT) —												
Unreserved — special revenue funds	<u>8,048,857</u>	<u>5,923,460</u>	<u>10,905,139</u>	<u>(19,562,241)</u>	<u>15,357,762</u>	<u>11,455,442</u>	<u>5,429,499</u>	<u>24,362,422</u>	<u>781,118</u>	<u>2,121,116</u>	<u>(4,881,919)</u>	<u>59,940,655</u>
<b>TOTAL</b>	<u>\$8,450,562</u>	<u>\$5,937,877</u>	<u>\$11,271,522</u>	<u>\$22,020,599</u>	<u>\$15,869,699</u>	<u>\$11,760,001</u>	<u>\$5,500,290</u>	<u>\$24,502,307</u>	<u>\$3,634,909</u>	<u>\$2,154,096</u>	<u>\$308,103</u>	<u>\$111,409,965</u>

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES INFORMATION — OTHER NONMAJOR GOVERNMENTAL FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	AHMSF Stage 2	AHMSF Stage 3	AHMSF Stage 6	AHMSF Stage 7	AHMSF Stage 8	AHMSF Stage 9	AHMSF Stage 10	AHMSF Stage 11	AHMSF Mortgage- Backed Certificates	AHMSF Act No. 124	New Secure Housing Program	Special Obligations Refunding Bonds — Debt Service	The Key for You Home Program	Total Other Nonmajor Governmental Funds
<b>REVENUES:</b>														
Commonwealth appropriations for repayment of bonds or housing assistance programs	\$ -	\$ -	\$ -	\$ 256,831	\$ -	\$ -	\$ 904,850	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,161,681
Interest income on deposits placed with banks				6,715						32,115	121	27,392	24,278	90,621
Interest income on investments and investment contracts	467,199	330,483	578,762	1,463,322	829,897	492,243	223,519	4,024	113,447	34,896				4,537,792
Interest income on loans												27,617		27,617
Net increase in fair value of investments	386	4,474	16,590		20,002					2,141				43,593
Net gain on sale of foreclosed real estate available for sale				26,200								67,600		93,800
Other										33,722	253,157	2,637	1,297,822	1,587,338
<b>Total revenues</b>	<b>467,585</b>	<b>334,957</b>	<b>595,352</b>	<b>1,753,068</b>	<b>849,899</b>	<b>492,243</b>	<b>1,128,369</b>	<b>4,024</b>	<b>113,447</b>	<b>102,874</b>	<b>253,278</b>	<b>125,246</b>	<b>1,322,100</b>	<b>7,542,442</b>
<b>EXPENDITURES:</b>														
<b>Current:</b>														
General government and other	5,005	5,003	11,001	8,501	8,499			47,000		4,001	7,600			96,610
Housing assistance programs	341,334	157,987	463,793	1,785,081	655,683	728,781	612,339	309,987	1,916,399	23,253	6,043,896		1,042,808	14,081,341
Debt service:														
Principal											1,851,918			1,851,918
Interest				794,341				904,863			1,459,897			3,159,101
<b>Total expenditures</b>	<b>346,339</b>	<b>162,990</b>	<b>474,794</b>	<b>2,587,923</b>	<b>664,182</b>	<b>728,781</b>	<b>1,517,202</b>	<b>356,987</b>	<b>1,916,399</b>	<b>27,254</b>	<b>9,363,311</b>		<b>1,042,808</b>	<b>19,188,970</b>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES</b>	<b>121,246</b>	<b>171,967</b>	<b>120,558</b>	<b>(834,855)</b>	<b>185,717</b>	<b>(236,538)</b>	<b>(388,833)</b>	<b>(352,963)</b>	<b>(1,802,952)</b>	<b>75,620</b>	<b>(9,110,033)</b>	<b>125,246</b>	<b>279,292</b>	<b>(11,646,528)</b>
<b>OTHER FINANCING SOURCES (USES):</b>														
Proceeds from issuance of long-term debt							13,920,777				6,606,786			20,527,563
Transfers in				31,436,410		340,458		507	1,706,218	1,496,751	9,415,828			44,396,172
Transfers out						(492,404)	(564,051)	(4,184,559)		(18,906,795)		(31,436,410)	(14,881,804)	(70,466,023)
<b>Total other financing sources (uses) — net</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>31,436,410</b>	<b>(151,946)</b>	<b>13,356,726</b>	<b>(4,184,052)</b>	<b>1,706,218</b>	<b>(17,410,044)</b>	<b>16,022,614</b>	<b>(31,436,410)</b>	<b>(14,881,804)</b>	<b>(5,542,288)</b>	
<b>NET CHANGES IN FUND BALANCES</b>	<b>121,246</b>	<b>171,967</b>	<b>120,558</b>	<b>30,601,555</b>	<b>185,717</b>	<b>(388,484)</b>	<b>12,967,893</b>	<b>(4,537,015)</b>	<b>(96,734)</b>	<b>(17,334,424)</b>	<b>6,912,581</b>	<b>(31,311,164)</b>	<b>(14,602,512)</b>	<b>(17,188,816)</b>
<b>FUND BALANCES — Beginning of year</b>	<b>7,927,611</b>	<b>5,751,493</b>	<b>10,784,581</b>	<b>(50,163,796)</b>	<b>15,172,045</b>	<b>11,843,926</b>	<b>(7,538,394)</b>	<b>28,899,437</b>	<b>877,852</b>	<b>19,455,540</b>	<b>(11,794,500)</b>	<b>31,311,164</b>	<b>14,602,512</b>	<b>77,129,471</b>
<b>FUND BALANCES — End of year</b>	<b>\$ 8,048,857</b>	<b>\$ 5,923,460</b>	<b>\$10,905,139</b>	<b>\$(19,562,241)</b>	<b>\$15,357,762</b>	<b>\$ 11,455,442</b>	<b>\$ 5,429,499</b>	<b>\$ 24,362,422</b>	<b>\$ 781,118</b>	<b>\$ 2,121,116</b>	<b>\$(4,881,919)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 59,940,655</b>

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
(A Component Unit of Government Development Bank for Puerto Rico)

**COMBINING BALANCE SHEET INFORMATION — OTHER NONMAJOR ENTERPRISE FUNDS**  
AS OF JUNE 30, 2010

	Mortgage Loan Insurance	Land Acquisition and Construction Loan Insurance	Home Purchase Stimulus Program	Single-Family Mortgage Revenue Bonds Portfolio X	Single-Family Mortgage Revenue Bonds Portfolio XI	Homeownership Mortgage Revenue Bonds	Homeownership Mortgage Revenue Bonds (Series 2001)	Homeownership Mortgage Revenue Bonds (Series 2003)	Total Other Nonmajor Enterprise Funds
<b>ASSETS</b>									
<b>CURRENT ASSETS:</b>									
Due from other funds	\$ 5,482	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5,482
Restricted:									
Cash	263,336	259	16,929,622		9,995		576		17,203,788
Deposits placed with banks	58,066,352	870,190	1,989,463	95,336	31,125	111,681			61,164,147
Investments and investment contracts					101,864			459,009	560,873
Accrued interest receivable	278,366	2,810	3,428	347,687	86,400	223,779	242,643	83,058	1,268,171
Other receivables	147,200								147,200
Total current assets	<u>58,760,736</u>	<u>873,259</u>	<u>18,922,513</u>	<u>443,023</u>	<u>229,384</u>	<u>335,460</u>	<u>243,219</u>	<u>542,067</u>	<u>80,349,661</u>
<b>NONCURRENT ASSETS:</b>									
Restricted:									
Investments and investment contracts	2,602,689			83,735,187	20,398,121	54,403,479	59,659,974	21,755,413	242,554,863
Loans receivable — net			13,507,554						13,507,554
Real estate available for sale	1,339,669								1,339,669
Deferred debt issue costs			163,252	1,901,766	2,115,513		53,866	70,806	4,305,203
Total noncurrent assets	<u>3,942,358</u>	<u>-</u>	<u>13,670,806</u>	<u>85,636,953</u>	<u>22,513,634</u>	<u>54,403,479</u>	<u>59,713,840</u>	<u>21,826,219</u>	<u>261,707,289</u>
<b>TOTAL</b>	<u>\$ 62,703,094</u>	<u>\$ 873,259</u>	<u>\$ 32,593,319</u>	<u>\$ 86,079,976</u>	<u>\$ 22,743,018</u>	<u>\$ 54,738,939</u>	<u>\$ 59,957,059</u>	<u>\$ 22,368,286</u>	<u>\$ 342,056,950</u>

(Continued)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
(A Component Unit of Government Development Bank for Puerto Rico)

**COMBINING BALANCE SHEET INFORMATION — OTHER NONMAJOR ENTERPRISE FUNDS**  
AS OF JUNE 30, 2010

	Mortgage Loan Insurance	Land Acquisition and Construction Loan Insurance	Home Purchase Stimulus Program	Single-Family Mortgage Revenue Bonds Portfolio X	Single-Family Mortgage Revenue Bonds Portfolio XI	Homeownership Mortgage Revenue Bonds	Homeownership Mortgage Revenue Bonds (Series 2001)	Homeownership Mortgage Revenue Bonds (Series 2003)	Total Other Nonmajor Enterprise Funds
<b>LIABILITIES AND NET ASSETS</b>									
<b>CURRENT LIABILITIES:</b>									
Current liabilities payable from unrestricted assets —									
Due to other funds	\$ -	\$ -	\$ 150,000	\$ -	\$ -	\$ 7,451	\$ -	\$ -	\$ 157,451
Current liabilities payable from restricted assets:									
Accrued interest payable				334,430	82,107	204,100	218,618	91,078	930,333
Accounts payable and accrued liabilities	452,485		20,658,000	3,294	26,920	155,432	66,348	3,856	21,366,335
Bonds and notes payable				1,255,000	300,000	1,085,000	1,250,000	590,000	4,480,000
Total current liabilities payable from restricted assets	452,485	-	20,658,000	1,592,724	409,027	1,444,532	1,534,966	684,934	26,776,668
Total current liabilities	452,485	-	20,808,000	1,592,724	409,027	1,451,983	1,534,966	684,934	26,934,119
<b>NONCURRENT LIABILITIES:</b>									
Noncurrent liabilities payable from restricted assets:									
Allowance for losses on mortgage loan insurance	346,330								346,330
Bonds and notes payable			7,752,626	72,370,000	18,610,000	46,820,000	48,970,000	22,725,000	217,247,626
Total noncurrent liabilities payable from restricted assets	346,330	-	7,752,626	72,370,000	18,610,000	46,820,000	48,970,000	22,725,000	217,593,956
Total liabilities	798,815	-	28,560,626	73,962,724	19,019,027	48,271,983	50,504,966	23,409,934	244,528,075
<b>NET ASSETS (DEFICIENCY):</b>									
Restricted for:									
Mortgage loan insurance	61,898,797								61,898,797
Affordable housing programs		873,259		12,117,252	3,723,991	6,474,407	9,452,093	(1,041,648)	31,599,354
Other housing programs			4,182,693						4,182,693
Unrestricted net assets (deficit)	5,482		(150,000)			(7,451)			(151,969)
Total net assets (deficiency)	61,904,279	873,259	4,032,693	12,117,252	3,723,991	6,466,956	9,452,093	(1,041,648)	97,528,875
<b>TOTAL</b>	<b>\$ 62,703,094</b>	<b>\$ 873,259</b>	<b>\$ 32,593,319</b>	<b>\$ 86,079,976</b>	<b>\$ 22,743,018</b>	<b>\$ 54,738,939</b>	<b>\$ 59,957,059</b>	<b>\$ 22,368,286</b>	<b>\$ 342,056,950</b>

(Concluded)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
(A Component Unit of Government Development Bank for Puerto Rico)

**COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS INFORMATION — OTHER NONMAJOR ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Mortgage Loan Insurance	Land Acquisition and Construction Loan Insurance	Home Purchase Stimulus Program	Single-Family Mortgage Revenue Bonds Portfolio X	Single-Family Mortgage Revenue Bonds Portfolio XI	Homeownership Mortgage Revenue Bonds	Homeownership Mortgage Revenue Bonds (Series 2001)	Homeownership Mortgage Revenue Bonds (Series 2003)	Total Other Nonmajor Enterprise Funds
OPERATING REVENUES:									
Investment income:									
Interest income on deposits placed with banks	\$ 588,208	\$ 8,141	\$ 8,013	\$ 80	\$ 1,528	\$ 1,144	\$ -	\$ -	\$ 607,114
Interest income on investments and investment contracts	172,894			4,426,890	947,133	2,805,657	3,098,232	1,048,471	12,499,277
Net increase in fair value of investments	<u>37,642</u>			<u>3,464,510</u>	<u>1,005,557</u>	<u>1,980,697</u>	<u>2,151,559</u>	<u>918,945</u>	<u>9,558,910</u>
Total investment income	798,744	8,141	8,013	7,891,480	1,954,218	4,787,498	5,249,791	1,967,416	22,665,301
Interest income on loans			<u>108,633</u>						<u>108,633</u>
Total investment income and interest income on loans	<u>798,744</u>	<u>8,141</u>	<u>116,646</u>	<u>7,891,480</u>	<u>1,954,218</u>	<u>4,787,498</u>	<u>5,249,791</u>	<u>1,967,416</u>	<u>22,773,934</u>
Noninterest income:									
Commitment, guarantee, service, and administrative fees	116,462					27,534	7,333		151,329
Mortgage loan insurance premiums	3,156,393								3,156,393
Other income	<u>13,565</u>								<u>13,565</u>
Total noninterest income	<u>3,286,420</u>					<u>27,534</u>	<u>7,333</u>		<u>3,321,287</u>
Total operating revenues	<u>4,085,164</u>	<u>8,141</u>	<u>116,646</u>	<u>7,891,480</u>	<u>1,954,218</u>	<u>4,815,032</u>	<u>5,257,124</u>	<u>1,967,416</u>	<u>26,095,221</u>
OPERATING EXPENSES:									
Provision for loan losses			<u>478,079</u>						<u>478,079</u>
Interest expense — Bonds and notes payable			<u>105,874</u>	<u>4,607,230</u>	<u>4,487,173</u>	<u>2,590,635</u>	<u>2,865,684</u>	<u>1,197,351</u>	<u>15,853,947</u>

(Continued)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
(A Component Unit of Government Development Bank for Puerto Rico)

**COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS INFORMATION — OTHER NONMAJOR ENTERPRISE FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

	Mortgage Loan Insurance	Land Acquisition and Construction Loan Insurance	Home Purchase Stimulus Program	Single-Family Mortgage Revenue Bonds Portfolio X	Single-Family Mortgage Revenue Bonds Portfolio XI	Homeownership Mortgage Revenue Bonds	Homeownership Mortgage Revenue Bonds (Series 2001)	Homeownership Mortgage Revenue Bonds (Series 2003)	Total Other Nonmajor Enterprise Funds
Other noninterest expenses:									
Legal and professional fees	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 99,322	\$ -	\$ -	99,322
Subsidy and trustee fees				14,441	28,613	13,657	30,141	14,771	101,623
Provision for losses on mortgage loan insurance	157,678								157,678
Other	948,628								948,628
Total noninterest expense	1,106,306	-	-	14,441	28,613	112,979	30,141	14,771	1,307,251
Total operating expenses	1,106,306	-	583,953	4,621,671	4,515,786	2,703,614	2,895,825	1,212,122	17,639,277
OPERATING INCOME (LOSS)	2,978,858	8,141	(467,307)	3,269,809	(2,561,568)	2,111,418	2,361,299	755,294	8,455,944
NONOPERATING REVENUES — Contributions from Commonwealth of Puerto Rico			4,500,000						4,500,000
TRANSFERS IN				223,593	4,184,559			128,090	4,536,242
TRANSFERS OUT					(507)		(128,090)		(128,597)
CHANGE IN NET ASSETS	2,978,858	8,141	4,032,693	3,493,402	1,622,484	2,111,418	2,233,209	883,384	17,363,589
NET ASSETS — Beginning of year	58,925,421	865,118		8,623,850	2,101,507	4,355,538	7,218,884	(1,925,032)	80,165,286
NET ASSETS — End of year	\$ 61,904,279	\$ 873,259	\$ 4,032,693	\$ 12,117,252	\$ 3,723,991	\$ 6,466,956	\$ 9,452,093	\$ (1,041,648)	\$ 97,528,875

(Concluded)

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

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<b>Federal Grantor/Pass-Through Grantor/ Program or Cluster Title</b>	<b>Federal CFDA or Grant Number</b>	<b>Expenditures</b>
<b>Department of Housing and Urban Development (HUD):</b>		
Section 8 Housing Choice Vouchers	14.871	\$ 12,432,956
Section 8 Project Based Cluster:		
Lower Income Housing Assistance Program –		
Section 8 Moderate Rehabilitation	14.856	2,217,911
Housing Assistance Payments Program –		
Special Allocations	14.195	109,908,741
ARRA — Tax Credit Assistance Program	14.258	28,039,950
<b>Department of Homeland Security:</b>		
<b>Pass-through from Commonwealth of Puerto Rico Governor’s Office –</b>		
Hazard Mitigation Grant Program	97.039	<u>1,638,920</u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>		<u><u>\$ 154,238,478</u></u>

See notes to Schedule of Expenditures of Federal Awards.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**AS OF AND FOR THE YEAR ENDED JUNE 30, 2010**

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1. **Basis of Presentation** — The accompanying schedule of expenditures of federal awards includes the federal grant activity of Puerto Rico Housing Finance Authority, and is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The Authority's government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, which conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The accounts of the Authority are presented on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance/net assets, revenues and expenditures/expenses. Government resources are allocated to and accounted for by individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

A reconciliation of total expenditures related to federal programs included in the statement of revenues, expenditures, and changes in fund balances — governmental funds to total expenditures included in the schedule of expenditures of federal awards is as follows:

Major Funds:	
HUD Programs	\$ 124,559,608
ARRA Programs	86,636,311
Other Nonmajor Governmental Funds — New Secure Housing Program	9,363,311
Less:	
State share of expenditures of Hazard Mitigation Grant Program included in Other Nonmajor Governmental Funds — New Secure Housing Program	(7,724,391)
Grants given to the Authority for low-income housing projects in lieu of low-income housing credit allocations included in ARRA Programs fund	<u>(58,596,361)</u>
Total expenditures in schedule of expenditures of federal awards	<u>\$ 154,238,478</u>

2. **Catalog of Federal Domestic Assistance (CFDA)** numbers are presented for programs for which such numbers are available.
3. **Reporting Entity** — The Authority, for purposes of the Schedule of Expenditure of Federal Awards, includes all funds of the primary government as defined by GASB Statement No. 14, *The Financial Reporting Entity*, as amended.

**PUERTO RICO HOUSING FINANCE AUTHORITY**

**PART II**

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS**

## **INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Members of the Board of Directors of  
Puerto Rico Housing Finance Authority:

We have audited the financial statements of Puerto Rico Housing Finance Authority (the "Authority"), a component unit of Government Development Bank for Puerto Rico, as of and for the year ended June 30, 2010, and have issued our report thereon dated November 5, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that results in reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as described above.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The

results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as item 10-1.

We noted certain matters that we reported to the Audit Committee of Government Development Bank for Puerto Rico in a separate letter dated November 5, 2010.

This report is intended solely for the information and use of management, the Authority's board of directors, others within the Authority, and federal and state awarding agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

November 5, 2010

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**PUERTO RICO HOUSING FINANCE AUTHORITY**

**PART III**

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH  
REQUIREMENTS THAT COULD HAVE A DIRECT AND  
MATERIAL EFFECT ON EACH MAJOR PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE  
IN ACCORDANCE WITH OMB CIRCULAR A-133**

## **INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Members of the Board of Directors of  
Puerto Rico Housing Finance Authority:

### **Compliance**

We have audited the compliance of Puerto Rico Housing Finance Authority (the "Authority"), a component unit of Government Development Bank for Puerto Rico, with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Authority's major federal programs for the year ended June 30, 2010. The Authority's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of the Authority's major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Authority's compliance with those requirements.

As described in item 10-1 in the accompanying schedule of findings and questioned costs, the Authority did not comply with the requirement regarding eligibility applicable to its Hazard Mitigation Grant Program. Compliance with such requirement is necessary, in our opinion, for the Authority to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs for the year ended June 30, 2010.

## Internal Control Over Compliance

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a material weakness.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying schedule of finding and questioned costs as item 10-1 to be a material weakness. The results of our audit procedures also disclosed another deficiency in internal control over compliance, which is described in the accompanying schedule of findings and questioned costs as item 10-2.

The Authority's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Authority's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, the Authority's board of directors, others within the Authority, and federal and state awarding agencies, and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche LLP*

March 11, 2011

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**PUERTO RICO HOUSING FINANCE AUTHORITY**

**PART IV**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

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**SECTION I – SUMMARY OF AUDITORS’ RESULTS**

1. The independent auditors’ report on the basic financial statements expressed an unqualified opinion.
2. No material weaknesses in internal control over financial reporting were identified.
3. No significant deficiencies in internal control over financial reporting were reported.
4. No instances of noncompliance were identified that were considered material to the financial statements.
5. A material weakness in internal control over compliance with requirements applicable to a major federal award program was reported.
6. The independent auditors’ report on compliance with requirements applicable to major federal award programs expressed a qualified opinion on the Authority’s Hazard Mitigation Grant Program and an unqualified opinion on other major programs.
7. The audit disclosed findings required to be reported by OMB Circular A-133.
8. The Authority’s major programs were:

<b>Name of Federal Program</b>	<b>CFDA Number</b>
Section 8 Housing Choice Vouchers	14.871
Section 8 Project Based Cluster:	
Lower Income Housing Assistance Program – Section 8	
Moderate Rehabilitation	14.856
Housing Assistance Payments Program – Special Allocations	14.195
ARRA — Tax Credit Assistance Program	14.258
Hazard Mitigation Grant Program	97.039

9. A threshold of \$3,000,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
10. The Authority did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

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**SECTION II – FINANCIAL STATEMENTS FINDINGS**

The audit of the financial statements of the Authority as of and for the year ended June 30, 2010, disclosed no financial statement findings. We noted certain matters that we reported to the Audit Committee of the Government Development Bank for Puerto Rico in a separate letter dated November 5, 2010.

**PUERTO RICO HOUSING FINANCE AUTHORITY**  
**(A Component Unit of Government Development Bank for Puerto Rico)**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2010**

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**SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS:**

<b>Reference Number</b>	<b>Findings</b>	<b>Questioned Costs for the Year Ended June 30, 2010</b>
<b>Hazard Mitigation Grant Program — CFDA No. 97.039</b>		
10-1	The Authority did not include the restrictive covenants in the deeds of properties from which structures were previously removed.	\$ -
<b>Section 8 Project Based Cluster — Housing Assistance Payments Program — Special Allocations — CFDA No. 14.195</b>		
10-2	The Authority did not properly monitor a project owner's compliance with residual receipts deposit requirement.	_____
	<b>Total</b>	<b>\$ -</b>

## **Finding Number 10-1**

**Federal program** – Hazard Mitigation Grant Program, CFDA No. 97.039

**Category** – Compliance

**Compliance requirement** – Eligibility

**Condition** – The Authority did not include the restrictive covenants in the deeds of properties from which structures were removed. During our tests of eligibility, we found that in two out of 25 participants selected, the Authority did not include the restrictive covenants in the deeds of properties from which structures were removed.

In addition, we found that new structures were built in two hazard-prone areas that had been previously vacated under the Hazard Mitigation Grant Program. As a result, the hazard-prone area was repopulated; thus, exposing citizens to the perils of flood or hazard.

**Criteria** – The Agreement for Funding under the Federal Hazard Mitigation Grant Program requires the Authority to prepare a Land Acquisition Addendum Agreement and record this addendum with the deed of each acquired property. Such acquired properties will be deed restricted and maintained in perpetuity for uses compatible with open-space, recreational, or wetlands management practices.

Also, 44 CFR 206.434(e)(1) states that the following restrictive covenants shall be conveyed in the deed to any property acquired, accepted, or from which structures are removed:

- i. The property shall be dedicated and maintained in perpetuity for uses compatible with open space, recreational, or wetlands management practices; and
- ii. No new structures will be built on the property, except for certain exceptions.

**Effect** – The continued occurrence of this situation may result in the exposure to cost disallowances.

**Cause** – Lack of sufficient monitoring controls to ensure previously vacated areas are not repopulated.

**Questioned Costs** – None

**Recommendation** – The Authority should strengthen internal controls to ascertain that no new structures are built in hazard-prone areas.

**Views of Responsible Officials** – Management's response is included as part of the Corrective Action Plan prepared by the Authority.

**Finding Number 10-2**

**Federal program** – Section 8 Project Based Cluster: Housing Assistance Payments Program – Special Allocations – CFDA No. 14.195

**Category** – Internal Control Over Compliance

**Compliance requirement** – Special Tests and Provisions

**Condition** – The Authority has not established formal procedures to monitor a project owners’ compliance with residual receipts deposit requirement within the required timeframe. During our testing over special tests and provisions, we noted that only one project was required to make the annual deposit into the residual deposit account. The residual receipt deposit was made by this project 97 days after year-end.

**Criteria** – OMB Circular A-133, Compliance Supplement, states that any project funds in the project funds account (including earned interest) at the end of the fiscal year shall be deposited with the mortgagee or other HUD-approved depository in an interest bearing account. For projects under 24 CFR part 883, the funds must be deposited with the State Agency or other Agency-approved depository in an interest bearing account. Required deposits should be made within 60 days following year-end.

**Effect** – Failure to perform proper monitoring of required residual receipt deposits may result in the unauthorized use of residual deposits.

**Cause** – Lack of appropriate internal control to ascertain that project owners perform appropriate and timely computations of residual deposits, and make the required deposits on a timely basis.

**Questioned Costs** – None

**Recommendation** – The Authority should establish procedures to ascertain project owners: (1) perform appropriate and timely computations of residual deposits, (2) make the required deposit in the residual deposit account on a timely basis, and (3) monitor the activities of project owners on a timely basis.

**Views of Responsible Officials** – Management’s response is included as part of the Corrective Action Plan prepared by the Authority.

\* \* \* \* \*

**PUERTO RICO HOUSING FINANCE AUTHORITY**

**PART V**

**CORRECTIVE ACTION PLAN**

**PUERTO RICO HOUSING FINANCE CORPORATION**  
**CORECTIVE ACTION PLAN**  
**June 30, 2010**

Reference Number	Finding	Recommendation	Person(s) Responsible for the CAP	Corrective Action Planned	Completion Date and %
10-1	<p>Hazard Mitigation Grant Program, CFDA No. 97.039</p> <ul style="list-style-type: none"> <li>The Authority did not include the restrictive covenants in the deeds of properties from which structures were removed. During our tests of eligibility, we found that in two out of 25 participants selected, the Authority did not include the restrictive covenants in the deeds of properties from which structures were removed.</li> </ul> <p>In addition, we found that new structures were built in two hazard-prone areas that had been previously vacated under the Hazard Mitigation Grant Program. As a result, the hazard-prone area was repopulated; thus, exposing citizens to the perils of flood or hazard.</p>	<p>The Authority should strengthen internal controls to ascertain that no new structures are built in hazard-prone areas.</p>	<p>Harry Torres</p>	<p>As required by the "Agreement for Funding" under the Federal Hazard Mitigation Grant Program and the 44 CFR 206.434 (e) (1), the Authority's New Secure Housing Program ("NSHP") has recorded and submitted the amount of 1,074 out of 1,106 possible deeds restrictions at this moment with the restrictive covenants related to NSHP participants as of February 28, 2011. Additional deeds restrictions are in process waiting for the necessary documents to be completed and then submitted to the corresponding government agencies including FEMA.</p> <p>With respect to the construction in hazard-prone areas, is to our knowledge that no new structures have been built on previously vacated land except for Villas Del Sol in Toa Baja. In reference to the finding of new construction structure in hazard-prone areas, we are sure that some structures submitted for participation in NSHP were not demolished by the date of the finding and are in process to be demolished as per requirements of FEMA, the "Agreement for Funding" and the 44 CFR 206.434 (e) (1). The Puerto Rico Department of Housing, as program subgrantee and responsible for the periodical inspection and monitoring of the restricted areas, is still working with FEMA to complete an Open Space Action Plan to finally determine the activities and uses compatible for restricted land .</p>	<p>June 2011</p> <p>90%</p>

Reference Number	Finding	Recommendation	Person(s) Responsible for the CAP	Corrective Action Planned	Completion Date and %
10-2	<p>Section 8 Project Based Cluster: Housing Assistance Payments Program – Special Allocations – CFDA No. 14.195</p> <ul style="list-style-type: none"> <li>The Authority has not established formal procedures to monitor a project owners' compliance with residual receipts deposit requirement within the required timeframe. During our testing over special tests and provisions, we noted that only one project was required to make the annual deposit into the residual deposit account. The residual receipt deposit was made by this project 97 days after year-end.</li> </ul>	<p>The Authority should establish procedures to ascertain project owners: (1) perform appropriate and timely computations of residual deposits, (2) make the required deposit in the residual deposit account on a timely basis, and (3) monitor the activities of project owners on a timely basis.</p>	<p>Miguel González/ Karen Soto</p>	<p>The Authority established a procedure to properly monitor and follow up Project owner's compliance with residual receipts deposits requirement.</p> <p>The established procedure includes :</p> <ol style="list-style-type: none"> <li>1. Verify the projects that require residual deposits.</li> <li>2. Annually, on December 1, we will send a letter to the project, requesting the preliminary financial statements. The due date should be January 31. If the documents are not received on the due date mentioned above, we will send another advice to ensure timely compliance.</li> <li>3. We will review the Financial Statements; if we detected any difference, we proceed with the action required.</li> </ol>	<p>March 2011  100%</p>

**PUERTO RICO HOUSING FINANCE AUTHORITY**

**PART VI**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS**

**PUERTO RICO HOUSING FINANCE CORPORATION**  
**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS**  
**June 30, 2010**

Reference Number	Finding	Recommendation	Person(s) Responsible for the CAP	Corrective Action Planned	Completion Date and %	Status/ Comments
09-1	<p>Lack of appropriate internal control over financial reporting resulted in several adjustments to recorded balances as of and for the year ended June 30, 2009, some of which involved significant amounts as follows:</p> <ul style="list-style-type: none"> <li>• The Authority recorded amounts for services not yet performed under contracts as part of its accounts payable in its New Secure Housing Program Fund. This situation resulted in an overstatement of accounts payable of \$1,032,880 at June 30, 2009.</li> <li>• The Authority recorded commitments to provide closing cost subsidies under the Key for Your Home Program as part of its accounts payable. This situation resulted in an overstatement of accounts payable of \$1,397,646 at June 30, 2009.</li> <li>• The Authority did not</li> </ul>	<p>Procedures should be implemented to: (1) evaluate the validity of accounts payable; (2) evaluate the validity of accounts receivable; and ascertain all journal entries determined from its analysis of its significant estimates are recorded on a timely basis.</p>	<p>Carmen Cordero/ Mayra I. Guadalupe</p> <p>José Sierra/Ismael Cardona</p> <p>Miguel González/</p>	<p>All corrections were done to the accounts payable of the program. Since September 2009, the Authority is reviewing the validity of each payable report.</p> <p>All corrections were done to the accounts payable of the program. Since September 2009, the Authority is reviewing the validity of each payable reported.</p> <p>Management decided to use</p>	<p>September 2009</p> <p>100%</p>	<p>Completed</p>

Reference Number	Finding	Recommendation	Person(s) Responsible for the CAP	Corrective Action Planned	Completion Date and %	Status/ Comments
	record an adjustment of \$1,550,540 to decrease the allowance for single-family loan losses as determined in its analysis of the allowance for loan losses at June 30, 2009. This situation resulted in an understatement of loans receivable in the Authority's Operating and Administrative Fund.		Luis Burdiel	a conservative approach and not to reduce the BV Fund reserve of \$12.8M. Despite the government's continuous efforts on executing strategies to activate economic activity, current performance could lead to the worsening and deterioration of Mortgage's portfolios. In addition, and based on the same economic conditions, we do not forecast portfolio growth due to a reduction in loan originations. We will continue to monitor performance. We are currently completing a reserve evaluation as of Dec/2009 and will use results to validate prior decision and adjust accordingly.		
09-2	The Authority did not review the utility allowance schedule for refrigerators and ranges during the year ended June 30, 2009. Thus, the Authority was unable to determine if there has been a change of ten percent or more in the utility allowance since the last review was performed.	The Authority should establish procedures to ascertain that a review of the utility allowance schedule is performed annually using the most recent information available. The utility allowance schedules must be revised whenever a change of ten percent or more occurs since the last revision.	Magdalena Rucabado/ Luis Berrios	Since November 2009 and each year we will verify the price of the refrigerators and stoves in the newspaper to determine whether had changed by 10 % or more	November 2009  100%	Completed
09-3	The Authority did not submit Form SF-269, <i>Financial Status Report</i> , on a quarterly basis to the Governor's Authorized Representative	The Authority should perform a complete and thorough analysis of its policies and procedures for the preparation and	Carmen Y. Cordero	From October 2009, the Authority has submitted on a monthly basis Form SF-269 (Financial Status Report) and Form SF-270 (Requisition	October 2009  100%	Completed

Reference Number	Finding	Recommendation	Person(s) Responsible for the CAP	Corrective Action Planned	Completion Date and %	Status/ Comments
	(GAR). Also, the Authority did not submit Form SF-270, <i>Requisition for Advance or Reimbursement</i> , to the GAR on a monthly basis.	submission of financial reports. The Authority should ensure that all applicable financial reports are submitted on a timely basis.		for Advance or Reimbursement) to the Governor's Authorized Representative office.		
09-4	The Authority did not include the restrictive covenants in the deeds of properties from which structures were removed.	The Authority should establish appropriate internal control to ascertain there are no constructions in hazard-prone areas.	Harry Torres Collazo	The Puerto Rico Department of Housing (Department), as program subgrantee, is responsible of periodically inspecting and monitoring the restricted lands in order to guarantee that they are maintained consistent with program regulations and the restrictive covenants. The Department is actively working with FEMA to complete an Open Space Action Plan to monitor the compliance with the restrictive covenants. This plan includes activities to ascertain no construction in hazard-prone areas.	June 2011 90%	As required by the "Agreement for Funding" under the Federal Hazard Mitigation Grant Program and the 44 CFR 206.434 (e) (1), NSHP has recorded and submitted the amount of 1,074 out of 1,106 possible deeds restrictions at this moment with the restrictive covenants related to NSHP participants approved as of February 28, 2011. Additional deeds restrictions are in process waiting for the necessary documents to be completed and then submitted to the corresponding government agencies including FEMA.  With respect to the construction in hazard-prone areas, is to our knowledge that no new structures have been built on previously vacated land except for Villas Del Sol in Toa Baja. The Puerto Rico Department of Housing, as program subgrantee and responsible for the periodical inspection and monitoring of the restricted areas, is still working with FEMA to complete an Open Space Action Plan to

Reference Number	Finding	Recommendation	Person(s) Responsible for the CAP	Corrective Action Planned	Completion Date and %	Status/ Comments
						<p>finally determined the activities and uses compatible with the land acquired.</p> <p>These situations in the summary schedule of prior year audit findings are also included as item 10-1 in the schedule of findings and questioned costs and corrective action plan as of June 30, 2010.</p>