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PROPERTY REPORT

Puerto Rico Aims to Solve Its Affordable-Housing Crisis

Government teams up with U.S. developer to build apartments with mixed rents

By Theresa Agovino

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Puerto Rico's Department of Housing is going to start developing projects with both market-rate and affordable units. A view of the Ciudadela Housing Development in San Juan. PHOTO: JOSÉ JIMÉNEZ-TIRADO FOR THE WALL STREET JOURNAL

Hope may be on the way for some 30,000 residents of Puerto Rico who are lingering on waiting lists for public housing and rent vouchers that can last up to four years.

Despite the island's financial crisis, Puerto Rico's Department of Housing is launching a trial program that is going to be using an affordable-housing tool that has been effective in other parts of the U.S. for years.

Teaming up with for-profit McCormack Baron Salazar, the department is going to start developing projects with both market-rate and affordable units. The

higher rents from the market-rate units make it possible to add to the island's affordable-housing stock and revitalize neighborhoods.

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Last year, the Housing Department and McCormack completed a plan to develop a total of 752 units in three developments for a cost of \$170.3 million. Two will be in San Juan while the third will be in Caguas, about a half-hour drive south from the capital.

The majority of the units—509 apartments—will be rented at affordable rents to very low-income families, most of whom will only earn up to 40% of the area's average median income. Meanwhile, 129 apartments are slated to house low-income families, or those earning up to 60% of the median income.

The remaining 114 units will be market rate. Rents for all the units are still being determined.

Ordinarily a project with this mixture of rents wouldn't be financially feasible because the income wouldn't be sufficient to pay operating expenses, debt service on construction loans and provide a return on equity to the developer.

But, like developers of affordable-housing projects in the U.S., the Puerto Rico venture is getting an unusual mixture of financing.

The developments will get \$105.2 million from the sale of tax credits. Puerto Rico's housing agency also is lending McCormack \$65.1 million including \$56 million the agency is getting from the U.S. Department of Housing and Urban Development.

McCormack has been building mixed-income housing to revitalize neighborhoods since 1973 and has completed 171 developments with almost 19,500 homes. The St. Louis-based firm answered a request for proposals issued

by Puerto Rico's government in 2014 for what would be its first mixed-income development on the island.

McCormack will be paid a development fee as well as a management fee once the housing opens. "This kind of project is our sweet spot," said Tony Salazar, president of McCormack's West Coast operation.

Mixed-income developments in the continental U.S. have proven to have positive results on community such as lowering crime and increasing property values.

But the Puerto Rico project still needs to generate enough revenue to pay expenses, the loan and management fees. Success depends on having market-rate rents that are high enough to compensate for the lower affordable-housing rates.

"You need the right mix to get enough income," said Michael Lappin, managing partner of MLappin & Associates, an advisory and development-services firm specializing in affordable housing. "I guess they figured out the right mix."

The project is an about face for the government, which said in the Puerto Rico State Housing Plan issued at the end of 2014 that the island wasn't yet ready for mixed-income projects because of the uncertainty of filling the market-rate units.



Puerto Rico's government is going to start developing more affordable units in San Juan. PHOTO: JOSÉ JIMÉNEZ-TIRADO FOR THE WALL STREET JOURNAL

Puerto Rico's financial problems may have exacerbated that ambiguity. Many Puerto Ricans are leaving the island in search of employment in the continental U.S. while other can't afford to pay rent. Housing vacancy rates surged 13% from 2010 to 2014, according to the Puerto Rico State Housing Plan report.

Mr. Lastra Power isn't worried. He said that much of the housing vacancy today is in the luxury market and believes college graduates and young couples will be attracted to the market-rate units.

Puerto Rican officials are hoping they can replicate the benefits of the project. They envision the projects enticing other developers to the same neighborhoods, creating hubs of economic activity that will help ease Puerto Rico's financial crisis.

"After many years, the government is focusing on bringing a new landscape to affordable housing," said Ricardo Alvarez-Diaz, founder and principle of Alvarez-Diaz & Villalon, an architecture firm that is designing the projects. "When this works there will be copy cats."

Mr. Salazar said the company isn't especially concerned about Puerto Rico's finances. "Of course the situation makes your antenna go up," he said. "But we are used to it. We have worked in Detroit and Cleveland."

The first project is set to begin at the end of the month and be completed in October 2017. All the units are scheduled to be completed by April 2018.

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