BOARD MORTGAGE REVENUE BOND WORKSHOP
TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
TDHCA Board Room, 507 Sabine, Austin, TX 78701
September 16, 2005 9:00 AM

A G E N D A

CALL TO ORDER, ROLL CALL **CERTIFICATION OF QUORUM**	Elizabeth Anderson Chair of Board

PUBLIC COMMENT
The Board will solicit Public Comment at the beginning of the workshop and will also provide for Public Comment on each agenda item after the presentation made by staff.

The Board of the Texas Department of Housing and Community Affairs will meet to consider the following:

1.	Welcome and Introductions	Edwina Carrington
2.	Review of Strategies and Factors affecting TDHCA's single family bond indentures	Byron Johnson
3.	Adjourn	Elizabeth Anderson

To access this agenda and details on each agenda item in the board book, please visit our website at www.tdhca.state.tx.us or contact Susan Woods, TDHCA, 507 Sabine, Austin, Texas 78701, 512-475-3934 and request the information.

Individuals who require auxiliary aids, services or sign language interpreters for this meeting should contact Gina Esteves, ADA Responsible Employee, at 512-475-3943 or Relay Texas at 1-800-735-2989 at least two days before the meeting so that appropriate arrangements can be made.
Non-English speaking individuals who require interpreters for this meeting should contact Susan Woods, 512-475-3934 at least three days before the meeting so that appropriate arrangements can be made.

Texas Department of Housing and Community Affairs
TDHCA's Single Family Bond Indentures
Discussion Topics
September 2005

I. Strategies And Factors Affecting TDHCA's Single Family Bond Indentures' Wealth

The amount TDHCA is permitted to earn on tax-exempt bond issues is restricted under tax law. TDHCA's indenture wealth is largely determined by the dollar amount of mortgage assets it has created with its bonding authority. If TDHCA's mortgage asset base increases, TDHCA's indenture wealth should increase. If assets decline, so will profitability.

Generally, when TDHCA issues a series of bonds, interest rates on the underlying mortgage assets are set at rates which will, at a minimum, pay the interest on the outstanding liabilities, and at best will earn the maximum spread over the bond interest rates (1.125% for single family bonds and 1.50% for multifamily bonds) permitted under tax law. The ability for TDHCA to earn the maximum spread is primarily a factor of capital market conditions. For example, over the past two to three years it has been very difficult for TDHCA and other state HFAs to finance "full-spread" mortgage loans with 100% fixed-rate bond issues. Fortunately, today TDHCA has the ability to use a number of strategies and techniques to create "full spread" issues and thereby increase indenture wealth. In addition, there are various other financial and lending strategies where TDHCA's actions can impact indenture wealth. We discuss these strategies below.

There are also events that can occur once bonds have been issued which affect TDHCA's indenture wealth, and which are largely out of TDHCA's control. Mortgage prepayments, for example, shrink TDHCA's asset base and lead to lower profitability. Such factors are also outlined below. These "external" factors are discussed first.

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A. External Factors Which Impact Indenture Wealth

	Effect on Indenture			
Strategy/Factor	**Increasing Interest Rates**	**Declining Interest Rates**	**Advantages**	**Disadvantages**
1. Mortgage Prepayments	Negative	Negative	• May be recycled into new mortgage volume for ten years following bond issuance • Transactions generally structured with ability to redeem bonds from prepayments with no fee or premiums (special call options)	• Loss of Department income due to forgone future Department fees • May not be recycled into new mortgage volume ten years after bond issuance
2. Negative Arbitrage (Borrowing costs exceeds reinvestment rate)	Negative	Negative	• None	• Direct cost incurred by bond indenture during origination period
3. Mortgage Delinquencies (Late Payments)	Neutral	Neutral	• Mortgage loan still performing	• Increased payment lag
4. Mortgage Delinquencies (Foreclosures)	Negative	Negative	• Securitized mortgage principal and interest guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac • Whole loan principal and interest insured by mortgage pool policies	• Loss of Department income due to forgone future Department fees

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	Effect on Indenture			
Strategy/Factor	**Increasing Interest Rates**	**Declining Interest Rates**	**Advantages**	**Disadvantages**
5. IRS Arbitrage and Rebate Rules	Neutral	Neutral	• Prevents abuse of tax-exemption by issuers • No rebate obligation if funds spent within 18 months of issuance • No rebate obligation on interest from tax-exempt bond investments • No rebate obligation on debt service funds spent down within one year	• Income cannot exceed limits established by IRS code (1.125% for qualified mortgage bonds) • Must rebate excess earnings to IRS • No rebate if funds spent within 18 months of issuance (TDHCA set-asides) • No rebate on interest from tax-exempt bond investments (market risk)
6. GSE Legislation (Senate Bill 190)	Neutral	Neutral	• Sets limits on types of portfolio investments • Would not be permitted to purchase tax-exempt bonds and tax credits • No affordable housing fund • Creates a new regulator • Gives regulator authority to manage GSEs' risk • Reduces systemic risk	• Sets limits on types of portfolio investments • Would not be permitted to purchase tax-exempt bonds and tax credits • No affordable housing fund • Creates a new regulator • Gives regulator authority to manage GSEs' risk • Higher cost of capital

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B. Financing (F) and Lending (L) Strategies and Techniques Which Impact Indenture Wealth

	Effect on Indenture			
Strategy/Factor	**Increasing Interest Rates**	**Declining Interest Rates**	**Advantages**	**Disadvantages**
1. Increase Volume of Outstanding Mortgage Loans (L)	Positive	Positive	• Increased department income	• Increased monitoring, reporting and management responsibilities
2. Refunding of Outstanding Bonds (F)	Neutral	Positive	• Lower cost of capital • May provide subsidy for mortgage buy downs (economic refunding) • May provide release of cash (replacement refunding)	• Generally, optional redemption rights not exercisable until ten years after issuance
3. Restructuring of Outstanding Bonds (F)	Neutral	Positive	• Redemption of outstanding bonds • May provide release of cash	• Generally, optional redemption rights not exercisable until ten years after bond issuance • Generally, ability to sell or release mortgage collateral not available until ten years after bond issuance
4. Variable Rate Demand Bonds (F)	Negative	Positive	• Lower cost of capital • Able to attain full-spread mortgage rates	• Interest rate exposure in increasing interest rate environment if variable

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	Effect on Indenture			
Strategy/Factor	**Increasing Interest Rates**	**Declining Interest Rates**	**Advantages**	**Disadvantages**
			• Faster origination of mortgages • Less negative arbitrage	rate bonds are naked/unhedged
5. Interest Rate Swaps (Floating-to-Fixed) with Regard to Mortgage Originations (F)	Positive	Positive	• Lower cost of capital • Able to attain full-spread mortgage rates • Faster origination of mortgages • Par Call Options • Structuring and Execution Flexibility	• Various risks associated with derivative and mortgage instruments • Increased monitoring, reporting and management responsibilities
6. Interest Rate Swaps (Floating-to-Fixed) with Regard to Market Terminations (F)	Positive	Negative	• TDHCA may receive a termination payment if interest rates rise above the fixed-payor rate	• TDHCA may owe a termination payment if interest rates decline below the fixed payor-rate
7. Cross-Calling (F)	Neutral	Neutral	• Reduces debt service	• The "Universal Cap" provisions of the tax code may limit or decrease department income when full spread achieved • National bond and tax counsels opinions vary • Increased monitoring, reporting and management responsibilities
8. Mortgage Non-origination (L)	Negative	Negative	• None	• Loss of potential

	Effect on Indenture			
Strategy/Factor	**Increasing Interest Rates**	**Declining Interest Rates**	**Advantages**	**Disadvantages**
				Department income due to forgone future Department fees • Negative arbitrage, depending upon market conditions • May expose TDHCA to unexpended bond proceeds redemptions • Inefficient use of state volume cap resources
9. Mortgage Interest Rate Buy Downs (L)	Neutral	Positive	• Able to attain full-spread mortgage rates • Able to attain more competitive mortgage interest rates • Faster origination of mortgages • Higher probability of realizing department income	• Reinvestment risk, depending upon market conditions (if cash contribution)
10. Zero Percent Participating Loans (F) (L)	Neutral	Positive	• Able to attain full-spread mortgage rates • Able to attain more competitive mortgage interest rates	• IRS Code restrictions regarding type of qualifying loans

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	Effect on Indenture			
Strategy/Factor	**Increasing Interest Rates**	**Declining Interest Rates**	**Advantages**	**Disadvantages**
			• Obligated by IRS Code restrictions to use for economic purposes	
11. Periodic Interest Rate Resets (L)	Positive	Positive	• Ability to recover prior department contributions • Ability to create zero percent participation loans • Ability to maintain competitive interest rates in rising and declining interest rate markets	• Increased monitoring, reporting and management responsibilities • May not comply with TDHCA statutes
12. Mortgage Credit Certificates (L)	Neutral	Neutral	• Serves public purpose • Complements MRB program • No negative arbitrage • No capitalized interest • No payment lag • Nominal costs of issuance	• Decreased ongoing Department fee
13. Management	Positive	Positive	• Executive Director, Chief of Agency Administration, and Director of Bond Finance possess significant and broad financial and	• None

	Effect on Indenture			
Strategy/Factor	**Increasing Interest Rates**	**Declining Interest Rates**	**Advantages**	**Disadvantages**
			capital markets experience • TDHCA has knowledge of and experience with all of the factors, strategies and techniques listed above.	

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II. TDHCA's Revenue Bond Enterprise Fund Financials

All TDHCA Revenue Bond Funds are audited annually by an independent auditing firm. The auditors are on location twice a year, the first time to perform interim audit work through the first nine months of the fiscal year, and the second time to complete their audit work through the remaining of the fiscal year and to prepare the audited financial report. The audit is conducted in accordance with generally accepted auditing standards. Those standards require that the audit is planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as the overall financial statement presentation. Their work involves audit and review of all aspects of the revenue bond program including bond balances, investment balances, whole loan balances, mortgage backed security balances, interest accruals, premiums, discounts, amortizations, income, expenses, gains, losses, mark to market evaluations, etc.

All financial statements are prepared on the basis of the governmental proprietary fund concept as set forth by the Governmental Accounting Standards Board ("GASB"). The governmental propriety fund concept provides that financial activities operated similarly to private business enterprises and financed through fees and charges assessed primarily to users of the services are presented as a proprietary fund. Proprietary funds are accounted for on the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when the liability is incurred.

Interim, unaudited financials are prepared by the Department on a monthly basis for review by management. These reports are not published publicly and do not meet all of the requirements of reporting under GASB regulations. The annual audited financial statements, however, have been produced to comply with GASB reporting regulations.

Another significant report produced by the Department is the Quarterly Investment Report. This report is prepared in compliance with the Public Funds Investment Act and in accordance with GASB Statement No. 31 which requires certain types of investments to be reported at fair value on the balance sheet.