Executive Summary

The Department of Housing and Community Affairs' (Department) Bond Finance Division (Division) may not be calculating required transfers to the Housing Trust Fund in accordance with chapters 2306.204 and 2306.205 of the Texas Government Code. This statute requires the Department to undergo an annual audit of its unencumbered fund balance, and to transfer excess funds to the Housing Trust Fund based on a calculation set out in the statute. However, the Division may not have been calculating the transfer amount correctly since at least fiscal year 2000. As a result, as much as an additional $5.5 million may have been available to transfer to the Housing Trust Fund between fiscal years 2000 and 2002. The majority of the unencumbered funds are subject to the terms of the bond indentures, which require the Department to meet certain conditions set out in the indentures before these funds can be transferred to other programs. It is also important to consider that the Division reports that $12.9 million in funds from the bond program were used to support other housing programs between fiscal years 2000 and 2004, including programs normally funded by the Housing Trust Fund such as the Bootstrap Program.

The Bond Finance Division and The Housing Trust Fund

The Bond Finance Division is primarily responsible for administering the Department's mortgage revenue bond programs that provide below-market interest rate funds for single-family homebuyers and multifamily mortgage loans.

The Housing Trust Fund provides loans and grants to finance, acquire, rehabilitate, and develop affordable housing. The Housing Trust Fund administers various single- family programs, and also provides funds for other programs administered by the Department.

In fiscal year 2001, the Division obtained a letter from Moody's Investors Service (Moody's) that was used as guidance in how to perform the transfer calculation. The guidance obtained from Moody's describes how Moody's determines "total bonded indebtedness," which includes considering all bonds regardless of rating, and excluding certain bonds that the Department is not obligated to repay. However, the statute requires that the highest rated bonds (AAA and Aaa) be excluded from the calculation and that all other bonds be included. The revised interpretation based on the guidance from Moody's has resulted in no transfers from the bond program to the Housing Trust Fund since 2001.

There were approximately $2.5 million in transfers from the bond program to the Housing Trust Fund in fiscal years 2000 and 2001. Using the methodology outlined in the statute results in increased transfers in fiscal years 2000 to 2002, but no additional transfers after fiscal year 2002. This is because the large amount of the Department's multifamily bonds adversely affects the calculation. For example, in fiscal year 2012, the amount of the applicable multifamily bonds was over $900 million. As a result, depending on the amount of the bonds, there may never be additional funds available to transfer to the Housing Trust Fund.

The Department has recently indicated that they believe the calculation of the unencumbered fund balance should exclude the amounts tied to the bonds. However, the statute does not define the term "unencumbered fund" nor does it provide guidance on what to include in the calculation of the unencumbered fund balance. As a result, we did not recalculate the unencumbered fund balances using this interpretation.

Other Key Points

- The Division has not formally documented a policy regarding the methodology used to calculate the transfer amount.
- The Texas Government Code includes safeguards to prevent a transfer of funds if the transfer might result in an adverse effect on the Department's financial condition, or a downgrade in the rating of the Department's bonds. This requires that the Department obtain a recommendation to hold more funds in reserve from one of the nationally recognized bond rating agencies.

Summary of Recommendations

The Division should:

- follow the requirements of the statute when calculating transfers to the Housing Trust Fund, and seek guidance regarding the interpretation of the statute if necessary.
- formally document the methodology used for calculating the portion of the unencumbered fund balance that should transfer to the Housing Trust Fund. The documented methodology should ensure that the calculation complies with the requirements of the Texas Government Code.
- consider discussing with the bond rating agency(s) whether a recommendation to retain additional funds is appropriate given the current financial condition of the Department's bonds. If so, the Division should obtain the recommendations, requirements and conditions of the bond rating agency(s) in writing.

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Detailed Results

Chapter 1

The Bond Finance Division Should Ensure that the Requirements of Statute are Followed When Calculating Transfers to the Housing Trust Fund

The Bond Finance Division (Division) may not be calculating the amount of funds available for transfer to the Housing Trust Fund in accordance with the Texas Government Code. The Division does not determine what portion of the bonds outstanding are rated in the highest long-term debt rating category and does not exclude those bonds from the calculation as required by the statute. In addition, the Division is not including all of the applicable multifamily bonds when performing the calculation. As a result, there have been no transfers from the Division to the Housing Trust Fund since fiscal year 2001.

The Texas Government Code Chapter 2306.205(a) states that:

> "the housing finance division shall transfer to the housing trust fund an amount…equal to one-half of the housing finance division's unencumbered fund balances in excess of two percent of the division's total bonded indebtedness that is not rated on its own merits in the highest long-term debt rating category by one or more nationally recognized rating agencies."

We recalculated the Housing Trust Fund transfer amount by including multifamily and single family bonds, but excluding any bonds rated in the highest long-term debt rating category, defined as AAA, Aaa, or an equivalent rating. Our recalculation resulted in as much as $5.5 million in additional funds that could have transferred to the Housing Trust Fund between fiscal years 2000 and 2002, provided certain restrictions in the bond indentures were met. It is important to note that during this time period, $12.9 million in proceeds from the bond program were reportedly used to fund down payment assistance loans and several other housing programs that are also supported by the Housing Trust Fund, such as the Bootstrap Program.

The Division changed the method of calculation in fiscal year 2001 because of guidance they requested from Moody's Investors Service (Moody's). However, this guidance merely describes "Moody's determination of 'total bonded indebtedness' when assessing the overall credit strength of a state housing finance agency."

In addition, the Division does not have a documented policy for how to calculate the statutorily-required transfers to the Housing Trust Fund. The Division's current methodology was developed based on the January 18, 2001 letter from Moody's.

The Division should develop a methodology for calculating the transfer amount to the Housing Trust Fund that complies with the statute and should document and follow that methodology going forward.

Chapter 1-A

The Bond Finance Division Should Exclude the Highest Rated Bonds and Include the Multifamily Bonds When Calculating Total Bonded Indebtedness

The Bond Finance Division is including the highest rated bonds when calculating total bonded indebtedness. The Division does not determine what portion of the bonds outstanding are rated in the highest long-term debt rating category and does not exclude those bonds from the Division's calculation of total bonded indebtedness.

In addition, the Division does not include the Department's multifamily bonds in the calculation of total bonded indebtedness. With the exception of one multifamily bond series during fiscal years 2000 through 2008 for the South Texas Rental Project, no multifamily bonds were included when calculating total bonded indebtedness.

In addition to the requirement to transfer half of the amount in excess of 2% of any unencumbered funds that exceed the total bonded indebtedness after subtracting the AAA and Aaa bonds and including the applicable multifamily bonds, the statute (Government Code 2306.205(c) also provides for an alternative transfer amount under specific circumstances:

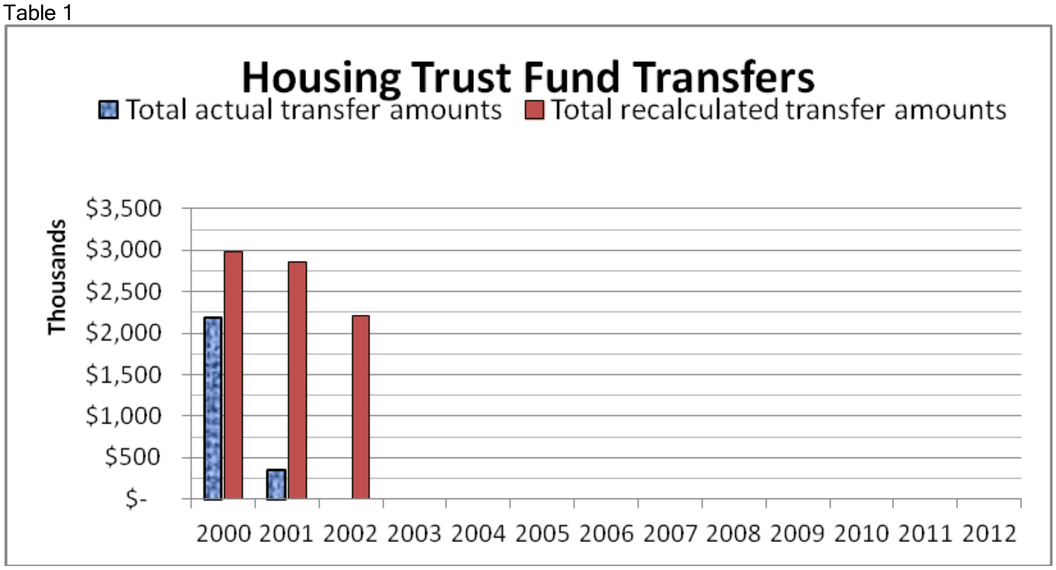
> "If…the housing finance division's unencumbered fund balances exceed four percent of its total bonded indebtedness that is not rated on its own merits in the highest long-term debt rating category, the department shall transfer…all amounts in excess of that four percent."

We recalculated the amount of the unencumbered fund balance that should have transferred to the Housing Trust Fund according to the statute. We used the same methodology the Bond Finance Division uses to determine the transfers to the Housing Trust Fund, but we excluded the bonds that were rated as AAA or the equivalent, and we included all other single family and multifamily bonds.

As a result, we determined that between fiscal years 2000 and 2002, as much as $8 million could have transferred to the Housing Trust Fund using the criteria set out in the statute. The Division actually transferred only $2.5 million to the Housing Trust Fund during this period. These transfers occurred in fiscal years 2000 and 2001. Consequently, the Department's transfers to the Housing Trust Fund were $5.5 million less than possible over the 13-year period. (See Table 1.) The majority of the unencumbered fund balance is composed of bond funds that are in excess of the amounts required to meet the assets to liabilities test ratio of 102%, plus a small amount of unrestricted operating funds. The bond funds carry certain restrictions that are set out in the bond indentures and included in the notes to the unencumbered fund balance report. These conditions must be met before the unencumbered funds can be used for other purposes.[1]

If the multifamily bonds that are not rated as AAA or the equivalent are included, it is unlikely that any funds will be available to transfer to the housing trust find in future years. Our recalculation yielded possible transfers in fiscal years 2000 to 2002, and no additional transfers in subsequent years. This is because the amount of multifamily bonds is extremely high. For example, in fiscal year 2012, the amount of the applicable multifamily bonds was over $900 million. If this situation continues, it is unlikely that the calculation will ever yield additional transfers to the Housing Trust Fund.

Table 1



[1] Generally, the unencumbered fund balances cannot be distributed or utilized except when certain conditions have been met within the bond trust indentures, including filing a statement of projected revenues that projects that anticipated cash flows will be sufficient to pay Department expenses of the Division and aggregate debt service through the maturity of the bonds and to maintain all other reserve fund requirements of the respective bond trust indentures. (*Notes to the Computation of Unencumbered Fund Balances as of August 31, 2012*, Note #2, page 5)

It is important to note that the Department reports that some proceeds from the bond program were used to finance other housing programs during this period, including $11 million for the Down-Payment Assistance Program and $1.9 million for the Bootstrap Program between fiscal years 2001 and 2004. (The Bootstrap Program is supported by the Housing Trust Fund.) However, we did not audit these transfers.

The unencumbered fund balance used in the calculation is determined by the Department's Financial Administration Division as part of the Department's Annual Financial Report (AFR) and is audited by the Department's external auditors. In fiscal years 2011 and 2012, the State Auditor's Office performed this audit. This requirement is set forth in Texas Government Code Chapter 2306.204(a), which states:

> "An independent auditor shall annually conduct an audit of the housing trust fund to determine the amount of unencumbered fund balances that is greater than the amount required for the reserve fund."

The Department has recently indicated that they believe the calculation of the unencumbered fund balance should exclude the amounts tied to the bonds. However, the statute does not define the term "unencumbered fund" nor does it provide guidance on what to include in the calculation of the unencumbered fund balance. As a result, we did not recalculate the unencumbered fund balances using this interpretation.

Recommendation

The Division should follow the requirements of the statute when calculating transfers to the Housing Trust Fund, and should seek guidance regarding the interpretation of statute if necessary.

Management's Response

Management agrees that it needs to commit to writing and implement a comprehensive standard operating procedure to clarify how staff will ensure that the requirements of TEX. GOV'T CODE, §§2306.201-205 are correctly and timely carried out and documented. Tim Nelson, Director of Bond Finance is the person designated to oversee the completion of this task, and the updated SOP will be completed and in place by August 30, 2013. Management agrees that all bond indebtedness issued by the Department other than bond indebtedness rated AAA or Aaa must be used in calculating the possible unencumbered fund balance transfers provided for in TEX. GOV'T CODE, §2306.205. As stated above, Chapter 1-A, the Department's bond counsel and Department staff advised that amounts that are subject to the lien of a trust indenture are encumbered and, accordingly, should not be treated as being included in the unencumbered fund balance. We understand that Internal Audit performed its audit based on prior years' audited calculations, but as noted in management's response, it appears that those prior calculations included amounts subject to indentures as being within the unencumbered fund balance. The new procedures staff will prepare will not treat amounts within indentures in that manner.

Chapter 1-B

The Bond Finance Division Should Formally Document the Methodology Used to Calculate Transfers to the Housing Trust Fund

The Division does not have a policy, or other documented methodology, for performing the calculation that determines what portion of the unencumbered fund balance should be transferred to the Housing Trust Fund according to statute.

The Division bases their calculation methodology on a letter received from Moody's Investors Service (Moody's) dated January 18, 2001. (See Appendix D.) The letter is "a response to your [the Department's] request for clarification on Moody's determination of 'total bonded indebtedness' when assessing the overall credit strength of a state housing finance agency." It explains how Moody's defines "total bonds outstanding" and "total bonded indebtedness". It also provides general guidelines on Moody's criteria for determining a housing finance agency's total indebtedness when assessing its overall financial position.

Some of the criteria described in the letter are in conflict with the Texas Government Code. The letter states:

> "In Moody's opinion, the total bonded indebtedness of an agency should incorporate any obligation for which the agency may potentially apply its fund balances to support the program, even if the programs are generally self-supporting. As such, Moody's calculation of an agency's debt position typically includes most types of debt obligations, even unenhanced Aaa-rated debt where the likelihood of the agency tapping its unrestricted fund balances to support the program is minimal."

The Moody's guidance suggests including AAA-rated debt in the Department's calculation of total bonded indebtedness. However, the Texas Government Code requires that, for the purposes of determining the amount of the unencumbered fund balance to be transferred to the Housing Trust Fund, the Department should consider only the "total bonded indebtedness that is not rated on its own merits in the highest long-term debt rating category…"

By using the Moody's letter as guidance in calculating total bonded indebtedness, the Division has been calculating the Housing Trust Fund transfer amount in a manner that may not comply with statute and that has resulted in no funds transferring to the Housing Trust Fund since fiscal year 2001.

Recommendation

The Division should formally document the methodology used for calculating the portion of the unencumbered fund balance that should transfer to the Housing Trust Fund. The documented methodology should ensure that the calculation complies with the requirements of the Texas Government Code.

Management's Response

Management agrees that it needs to commit to writing and implement a comprehensive standard operating procedure to clarify how staff will ensure that the requirements of TEX. GOV'T CODE, §§2306.201-205 are correctly and timely carried out and documented. Tim Nelson, Director of Bond Finance is the person designated to oversee the completion of this task, and the updated SOP will be completed and in place by August 30, 2013. Management agrees that all bond indebtedness issued by the Department other than bond indebtedness rated AAA or Aaa must be used in calculating the possible unencumbered fund balance transfers provided for in TEX. GOV'T CODE, §2306.205. As stated above, Chapter 1-A, the Department's bond counsel and Department staff advised that amounts that are subject to the lien of a trust indenture should be considered encumbered and, accordingly, should not be treated as being included in the unencumbered fund balance. We understand that Internal Audit performed its audit based on prior years' audited calculations, but as noted in management's response, it appears that those prior calculations included amounts subject to indentures as being within the unencumbered fund balance. The new procedures staff will prepare will not treat amounts within indentures in that manner.

Chapter 2

The Bond Finance Division Should Consider the Recommendations and Conditions of the Bond Rating Agency

The Division provided the 2001 letter from Moody's (see Chapter 1) as support for the methodology used to calculate transfers to the Housing Trust Fund. The Texas Government Code includes safeguards to prevent a transfer of funds if the transfer might result in an adverse effect on the Department's financial condition, or a downgrade in the rating of the Department's bonds.

Chapter 2306.205(e) of the Texas Government Code, subsection (e) states:

> "If, at the time an annual audit required by Section 2306.204 [the unencumbered fund balance] is concluded, a nationally recognized rating agency has recommended that the housing finance division increase the amount of its unencumbered fund balances to achieve or maintain a financially sound condition or to prevent a decrease in the long-term debt rating maintained on all or a portion of the housing finance division's bond indebtedness, the housing finance division may not make further annual transfers to the housing trust fund until all requirements and conditions of the rating agency have been met."

Once the Division has determined the methodology that should be used to calculate potential transfers to the Housing Trust Fund (see Chapter 1), and calculates the transfer correctly, it is possible that funds should be transferred that are not available, or that a required transfer could adversely affect the Department's financial condition or its bond ratings. If so, this condition could be avoided by following the requirements of subsection (e) above.

Recommendation

The Division should consider discussing with a bond rating agency whether a recommendation to retain additional funds is appropriate given the current financial condition of the Department's bonds and the requirements of the bond indentures. If so, the Division should obtain the recommendations, requirements and conditions of the bond rating agency in writing.

Management's Response

Written confirmation of such matters will be sought from the rating agencies in the future, if applicable; if the rating agencies are unwilling or unable to provide a dispositive statement the Department will use other reasonable measures, such as correspondence with its financial advisors to document any such conclusions. This *methodology will also be addressed in the SOP on the unencumbered fund balance which Tim Nelson, Director of Bond Finance will develop, to be completed by August 30, 2013.*

It is also noted with regard to the possible obtaining of written advice of the requirements of rating agencies for the establishment and maintenance of reserves or other dedicated resources to support bond indebtedness, that as a general rule such agencies will not provide such written direction. They establish, and frequently change, stress tests and other analyses that they perform in connection with rated debt securities, but performance under such analytics is not an assurance of maintaining a particular rating status and deficient performance under such analytics does not automatically result in a downgrade in rating status. Moreover, the presence of significant amounts of variable rate indebtedness within the Department's overall bond indebtedness and contractual obligations under related interest rate risk hedging instruments present additional related risks. Rating agencies, the Department, and the Department's liquidity provider (the Comptroller of Public Accounts) generally desire such interest rate risks to be addressed not only through the continued stable performance of the underlying bond indebtedness but through the dedication of reserves to address contingencies relating to changing interest rate environments.

Appendix A
Objectives, Scope and Methodology

Objectives

To determine if the Department is accurately calculating the portion of the unencumbered fund balance required to be transferred to the Housing Trust Fund in accordance with state statute.

Scope

The audit scope was state fiscal years 2000 through 2012.

Methodology

We obtained a preliminary understanding of the Bond Finance Division's fund transfer process by:

a) interviewing pertinent management and staff,
b) reviewing background information,
c) identifying manual and automated processes, critical points and activities directly related to the calculation of the statutorily-required transfer to the Housing Trust Fund,
d) identifying risks and the associated controls, and
e) collecting various types of evidence to document our understanding.

We did not recalculate the unencumbered fund balance or the amount of the bonds outstanding because these amounts were previously audited by the Department's external auditors as part of the Department's Annual Financial Reports. We did not verify transfers made from the bond program to other housing programs as reported by the Department during the audit, as these issues were not within our audit scope.

More specifically, we:

a) reviewed Texas Government Code Chapters 2306.204 and 2306.205,
b) reviewed the State Auditor's Office Report # 08-043,
c) interviewed staff in the Financial Administration Division to determine how the unencumbered fund balance is calculated,
d) interviewed staff in the Bond Finance Division to determine how the transfer amount is calculated,
e) interviewed staff in the Legal Division to determine the appropriate interpretation of the Texas Government Code,
f) obtained bond ratings for all of the Department's rated bonds over the past 13 years, and
g) recalculated the transfer amount by excluding AAA or Aaa rated bonds and including multifamily bonds that were not rated AAA or Aaa.

We used the following documents as criteria:

a) Texas Government Code Chapters 2306.204 and 2306.205,
b) The Department's Computation of Unencumbered Fund Balances as of August 31, 2012, and Independent Auditors' Report,
c) The Bond Finance Division's calculated amounts of required transfers to the Housing Trust Fund at fiscal year end for fiscal for fiscal years 2000 through 2012
d) The Department's bond ratings at fiscal year end for fiscal years 2000 through 2012
e) Moody's letter dated January 18, 2001

Type of Audit

This audit was a performance audit of the Bond Finance Division.

Report Distribution

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report was distributed to the:

- Texas Department of Housing and Community Affairs' Governing Board
- Governor's Office of Budget and Planning
- Legislative Budget Board
- State Auditor's Office
- Sunset Advisory Commission

Project Information

Audit fieldwork was conducted from January through February 2013. We conducted this audit in accordance with *Generally Accepted Government Auditing Standards*. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was also conducted in conformance with *the International Standards for the Professional Practice of Internal Auditing.*

The following staff performed this audit:

Derrick Miller, Project Manager
Nicole Elizondo, CFE, CICA

Appreciation to Staff

We would like to extend our sincere appreciation to management and staff of the Bond Finance Division, the Financial Administration Division and the Legal Division for their cooperation and assistance during the course of this audit.

Appendix B

Background

The Bond Finance Division (Division) is responsible for administering the Department's Mortgage Revenue Bond (MRB) programs. MRB programs provide below-market interest rate funds for single-family homebuyers and multifamily mortgage loans made to qualifying recipients. The Department issues tax-exempt municipal bonds, which yield tax exempt interest income to bondholders, but at below-market interest rates. This creates the subsidy required to achieve and offer below-market interest mortgage rates. The Department's authority to issue MRBs is derived from its enabling legislation and certain provisions of the Internal Revenue Code. The Department also has the ability, under certain circumstances, to restructure existing bonds issued and create additional funds for new single-family mortgage loans. As of fiscal year end 2012, the Department had $1.3 billion in single-family bonds outstanding and $1.1 billion in multifamily bonds outstanding.

The Housing Trust Fund administers various single-family programs, and provides funds to other programs administered by the Department. The goal of the Housing Trust Fund is to provide loans and grants to finance, acquire, rehabilitate, and develop decent and safe affordable housing.

Texas Government Code Chapter 2306.205 requires that the Housing Finance Division (Bond Finance Division) of the Department annually transfer to the Housing Trust Fund a portion of the unencumbered funds meeting certain thresholds and criteria.

Appendix C
Texas Government Code, Chapter 2306

Sec. 2306.204. INDEPENDENT AUDIT OF HOUSING TRUST FUND. (a) An independent auditor shall annually conduct an audit of the housing trust fund to determine the amount of unencumbered fund balances that is greater than the amount required for the reserve fund.

(b) The independent auditor shall submit the audit report to the board not later than December 31 of each year.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993.

Sec. 2306.205. TRANSFER OF MONEY TO HOUSING TRUST FUND. (a) Except as provided by Subsections (c), (d), and (e), not later than January 10 of each year the housing finance division shall transfer to the housing trust fund an amount, as determined by the audit report prepared under Section 2306.204, equal to one-half of the housing finance division's unencumbered fund balances in excess of two percent of the division's total bonded indebtedness that is not rated on its own merits in the highest long-term debt rating category by one or more nationally recognized rating agencies.

(b) The department shall determine the unencumbered fund balance under Subsection (a) according to the debt rating criteria established for housing finance agencies by one or more nationally recognized rating agencies.

(c) If, at the time an annual audit required by Section 2306.204 is concluded, the housing finance division's unencumbered fund balances exceed four percent of its total bonded indebtedness that is not rated on its own merits in the highest long-term debt rating category, the department shall transfer not later than January 10 of the next year all amounts in excess of that four percent.

(d) If, at the time an annual audit required by Section 2306.204 is concluded, a nationally recognized rating agency has recommended that the housing finance division maintain unencumbered fund balances in excess of the amount permitted by Subsection (a) to achieve or maintain a rating of at least Aa/A+ on all or a portion of the bonded indebtedness of the housing finance division that is issued under an open indenture or an open flow of funds, the department shall transfer not later than January 10 of the next year all amounts in excess of the amount required by the rating agency to be held as unencumbered fund balances.

(e) If, at the time an annual audit required by Section 2306.204 is concluded, a nationally recognized rating agency has recommended that the housing finance division increase the amount of its unencumbered fund balances to achieve or maintain a financially sound condition or to prevent a decrease in the long-term debt rating maintained on all or a portion of the housing finance division's bonded indebtedness, the housing finance division may not make further annual transfers to the housing trust fund until all requirements and conditions of the rating agency have been met.

(f) In addition to the money transferred into the housing trust fund under this section, and subject to Subsection (e), the department shall transfer into the fund the amount of any origination fee, asset oversight fee, and servicing fee the department or the Texas State Affordable Housing Corporation receives in relation to the administration of its 501(c)(3) bond program established pursuant to Section 2306.358 that exceeds the amount needed by the department or the Texas State Affordable Housing Corporation to pay its operating and overhead costs and fund reserves, including an insurance reserve or credit enhancement reserve established by the board in administering the program.

Added by Acts 1993, 73rd Leg., ch. 268, Sec. 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 980, Sec. 31, eff. Sept. 1, 1997.

Moody's Investors Service

Appendix D
Correspondence from Moody's Investors Service - January 18, 2001

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New York, New York 10007

Jina Yoon
Senior Associate
Public Finance Group
Tel: 212.553.1051

January 18, 2001

Mr. Byron Johnson
Bond Finance Director
Texas Department of Housing and Community Affairs
507 Sabine, Suite 900
Austin, TX 78711-3941

Dear Mr. Johnson:

This letter is a response to your request for clarification on Moody's determination of "total bonded indebtedness" when assessing the overall credit strength of a state housing finance agency.

Moody's assessment of the overall financial position of a housing finance agency incorporates various measurements of the agency's financial resources relative to its outstanding obligations. One such measurement is the agency's combined fund balance as a percentage of total bonds outstanding. Moody's defines "total bonds outstanding" as all debt obligations of the agency for which the agency's fund balances may be applied. This calculation typically includes both rated and nonrated debt, commercial paper programs, all single family programs (both whole loan and mortgage-backed securities programs), various types of multi-family debt and any other obligations of the agency. Moody's may, however, adjust the total bonds outstanding amount by excluding certain obligations for which the agency has no legal or financial obligation to repay such as conduit issuances whereby the housing agency solely issues debt for another entity and is not responsible for any potential losses to the program.

In Moody's opinion, the total bonded indebtedness of an agency should incorporate any obligation for which the agency may potentially apply its fund balances to support the program, even if the programs are generally self-supporting. As such, Moody's calculation of an agency's debt position typically includes most types of debt obligations, even unenhanced Aaa-rated debt where the likelihood of the agency tapping its unrestricted fund balances to support the program is minimal.

Another component of Moody's calculation of an agency's total bond indebtedness is the inclusion of "bonds outstanding" rather than what is typically found on the liability side of a balance sheet—"bonds payable." Bonds payable is a standard accounting entry that nets out unamortized discount from the amount of bonds actually outstanding. Moody's,

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however, is more interested in the amount of debt that is truly owed, i.e. the aggregate amount of principal outstanding that bondholders would be due as of the audit date if all bonds were to be due and payable. Because "bonds outstanding" is often higher than the reported "bonds payable," the adjusted number oftentimes results in a higher amount of liabilities.

While this letter is intended to provide you with general guidelines on Moody's criteria for determining an agency's total indebtedness when assessing its overall financial position, Moody's will make certain adjustments to these criteria on a case-by-case basis depending upon the circumstances of an individual agency.

If you have any questions about the issues raised in this letter or about Moody's criteria in general, please do not hesitate to call me.

Sincerely,

Jina Yoon