TEXAS DEPARTMENT OF HOUSING AND
COMMUNITY AFFAIRS

FINANCE COMMITTEE MEETING

10:00 a.m.
Thursday,
April 7, 2005

Room 437
Waller Creek Office Building
507 Sabine
Austin, Texas 78701

PRESENT:

AUDIT COMMITTEE:

Kent Conine, Vice Chairman
Shadrick Bogany

TDHCA STAFF:

Edwina Carrington
Byron Johnson

CONSULTANT:

Gary Machak

I N D E X

P R O C E E D I N G S

MR. CONINE: Call to order the Finance Committee meeting for the Texas Department of Housing and Community Affairs on Thursday, April 7. It is now close to ten o'clock.

I'll call the roll. Vidal Gonzalez, the Chair, is not here. Kent Conine is here. Shad Bogany is here. We've got a couple. That's enough.

Okay. Any -- if there is any public comment, you need to fill out a witness affirmation form and hand it to Penny up here. I've got two or three. And it looks like everybody would like to speak on Agenda Item Number 2, so we'll pass on the public comment and call these people at the appointed time.

We'll now go to the action items, which is the Presentation, Discussion and Possible Approval of the Minutes of Finance Committee Meeting of February 10.

MR. BOGANY: So moved.

MR. CONINE: There is a motion, and I'll second. Any discussion? Seeing none, all those in favor, say aye.

(A chorus of ayes.)

MR. CONINE: All opposed?

(No response.)

MR. CONINE: Motion carries. Item two -- we have some -- this is the Approval of Criteria and Methodology to Recommend the Selection of Co-Senior Managers in Conjunction with the Sale of our Single Family Mortgage Revenue Bonds. And Ms. Carrington, I'll turn it over to you, or at least ask would you rather here the public testimony now? Should we do this now, or should you give an opening soliloquy.

MS. CARRINGTON: It is your choice, Mr. Chair.

MR. CONINE: Why don't you open the subject up, and then I'll ask for some public comment.

MS. CARRINGTON: Thank you. In 2001, the board selected 12 investment banking firms to provide Single Family bond underwriting services for TDHCA. Six of those firms were selected to be single managers, and the board last month selected three firms to provide senior management investment banking services at the meeting last month.

You will remember that you went through a process of reviewing the evaluation criteria, and then evaluating the senior managers who had worked with the department. And from that process, we -- the board selected three senior managers to work on upcoming bond issues.

In the past, we have had a similar kind of process for the selection of co-senior managers. So actually, what we want to do today is give this committee a couple of options. And the first option would be to go through basically the same process we went in selecting senior managers, in approving the evaluation tool, and then selecting co-senior managers from that process.

And option number two is what some other state HFAs around the country do do. And that is just to eliminate the co-senior manager role and have a provision that the board would assign co-seniors on a bond-by-bond basis, and -- a bond-issue-by-bond-issue basis.

And that as we have investment bankers that bring new, innovative ideas to the department that are proposing bond issues that would have tangible economic benefit to the department, that that would be how the co-seniors would be selected, which would open the field up more, as opposed to having a list of co-senior managers.

So we thought maybe it was time for the committee to discuss how we do this on co-seniors. And so that's what we have in front of you all this morning. Obviously, what we're looking for regardless of the process that we use is firms who can bring tangible economic benefit to the department, and firms also that are being innovative and creative in their bond finance business.

MR. BOGANY: Does staff have a recommendation?

MS. CARRINGTON: We are going to let the committee discuss the options and the board discuss the options.

MR. CONINE: Let's go ahead and have some public comment first.

MS. CARRINGTON: Either way would work for us, Mr. Bogany.

MR. CONINE: My hunch is this is why we have some public comment generated. First I'd like to call Mark O'Brien to come up, please.

MR. O'BRIEN: Thank you, Mr. Chair, Mr. Bogany, Edwina -- Ms. Carrington. I'm Mark O'Brien with Morgan Keegan and Company in Dallas. We've had the pleasure and privilege of serving as -- or selected in 1996 as a co-senior -- in the co-senior managing underwriting group for TDHCA, and have since been a co-manager -- seven-and-a-half percent co-manager on about six year transactions, from 1997 to 2002, and are also named as co-manager on the current transaction.

I guess what I would say is I would applaud Bond Finance and Byron's efforts in the -- what you've done to kind of streamline this process a little bit. It seemed like kind of a large, unwieldy group, but I think the process was good to go through to get performance results from senior managers. So what you've done is kind of narrowed down your field, at least -- I don't know how far that's intended to go, a year, two years, indefinitely, I guess, until further review.

I think with respect to the co-senior and the co-manager pool, that would probably also be a beneficial thing to not have such a large group, but rather a more-focused group, for several reasons. A co-manager, or co-senior manager only gets to see TDHCA's bonds every one to three years. Obviously, there's not that level of focus for our sales group in terms of getting up for and selling your bonds.

So we think it's a positive process. We think that some criteria for this is good, too. We think that what's been put out is a good starting point, and a beneficial way to look at this in terms of rank and criteria.

And in terms of the two options, I could argue that flat around, I suppose, in terms of the first one, obviously, gets some -- gives you some background for firms that have been serving you before. The second one is sort of a case-by-case for innovative ideas.

We do happen to have an innovative idea in front of you right now. So if that happens to produce tangible results, I'm for number two.

But that's all. We thank you for the opportunity. We thank you for -- we appreciate the Bond Finance input in this process, and we look forward to the opportunity to continue to serve TDHCA on behalf of myself and Morgan Keegan.

MR. CONINE: Thank you, Mark. Any questions? Thank you. Dale Lehman?

MR. LEHMAN: Good morning, Mr. Chairman.

MR. CONINE: Good morning.

MR. LEHMAN: Mr. Bogany.

MR. BOGANY: Good morning.

MR. LEHMAN: Ms. Carrington. Thank you very much for giving me the opportunity and Piper Jaffray the opportunity to speak this morning. I, too, want to thank you all for having us as part of your underwriting team for the last three or four years.

As you well know, we've had an opportunity to be senior manager, co-manager, and co-senior managers. So we believe that we have some experience and knowledge to talk about this subject.

One of the things that I've done, and I apologize for bringing this letter in today. I was out of town Friday and Monday and Tuesday. I got onto the site and made this yesterday. So please, I would have liked to have got here earlier so you had a chance to review it.

As I've done before, I put my comments into two parts, a general overall comment, and then by factor as to what our thoughts are. As far as the general overall comments, we believe that a co-senior manager's primary responsibility is to provide significant sales and marketing support for the department's family -- Single Family Housing bonds.

Obviously, there are several major qualifications or factors, if you will, that are necessary for someone to perform at that level. I think Bond Finance has done a good job of highlighting what those are. We do have some comments and slight modifications in weighing recommendations we'd like to present.

But one of the most important qualifications that we feel you need to evaluate is the firm's proven performance with TDHCA's transactions. I believe most of the firms that's on your underwriting team today have had an opportunity to serve in one role or another. And you have a good track record of how we performed.

I've taken the liberty to put in some performance criteria that other state agencies have used in the past with regard to evaluating a co-senior manager or a co-manager's performance.

One of those is total member orders placed. Members' orders, as you know, are orders that are placed sometimes for staff, or maybe there is the possibility of an investor in the future.

We believe these are key orders if they're put in the right time. It helps a lot if you place these orders during the early part of the order period, where there is some need to fill certain areas in the structure.

And today, all these orders are timed, so you have an idea of when they are placed. If they're placed at the end of the order, they're not as important, not as key, because oftentimes there is already orders placed in those maturities.

The second is priority orders. And as you well know, it's usually very difficult for a co-senior manager or co-manager to get a priority order. It's been most of your buyers will place priority orders with the senior manager, with the idea being that they have a better chance of getting those orders filled.

So I believe that if a co-senior manager has the opportunity to bring a priority order to the transaction, that simply means that he either has a better relationship with an investor, or has a relationship with an investor the senior manager doesn't have. And bringing that order in can do nothing but lower the borrowing costs for TDHCA.

Finally, designations -- I think designations is a key evaluation as to how well a co-senior manager performs. If they're in the market, they know the investors, then these investors are going to designate them when they have the opportunity to do so.

A firm that communicates and talks to these investors will have a better chance to get that designation. And that, again, is a good indication of how well that firm markets your bonds, and how well they are regarded in the marketplace.

So in summary, as far as general comments, we believe total performance, and/or orders, give you a good idea as to the performance of a co-senior manager. I do agree that innovative ideas are important, and I do think that that's something that should be considered, but the larger-weighed in my opinion should be the performance on the actual sale.

I would like to, on the last page, just briefly go through the factors and give some general comments. As far as capital, on factors one and two, certainly I feel that a firm has to have enough capital to support a bond issue.

I think, again, based on the size of what TDHCA's transactions are, that capital can be maybe estimated as a minimum. But I certainly agree with the importance, and agree with the 5 percent weight factor for each of those, whether it's net capital or excess capital.

Sales and marketing -- again, as I mentioned, is in my opinion the most important part of a co-manager or co-senior manager's role. As you know, many firms have both retail and institutional capability. I believe, especially in housing bonds, there is a smaller market with regards to some of these bonds.

And having a good retail presence is very helpful, and it's always, when you get a retail order, it's usually at a lower interest rate, which again helps your overall borrowing cost.

So with that in mind, we recommend that you look at both our firm's retail capabilities and institutional capabilities, evaluate those separately, and give both of them a weighting factor of 10 percent, again, because of the importance of the underwriting.

As far as factor number five, the performance of TDHCA, as I said before, I think that's the most important factor that you can evaluate the actual records of how well somebody is focused on your transactions, how well they support it through their capital and through their efforts in marketing.

So I think that should be the key. And I would actually increase the weighted value of that to 40 percent.

With regards to prior amount negotiated single-family bonds, co-senior and co-manager, to my knowledge, Thompson does not -- and Thompson Financial is the -- I guess the firm that calculates and keeps track of everybody who does certain types of transactions with regards to Single Family housing.

They do not really truly break out co-senior manager and co-managers' transactions. So I do think it's important for co-senior managers to have housing marketing experience. So I think this is one way to get an indication of how well and how much activity they have in their marketplace. But I think it can be combined into one area, and that being a co-manager and giving full credit to that co-manager for those three years. And then that particular item be given 5 percent.

And then finally, a -- innovativeness -- as I said before, I agree with Byron and his group. Innovating is very key. But -- and I do think that that's something that should be looked at. But I think it should be given a lower weighting of 25 percent, because again, my feeling is the key job and role of the senior co-manager is to market and underwrite the bonds.

So with those comments, obviously I think we feel that Item -- Action Number 1 makes the most sense, because I think you can subjectively now, using these criteria, rank how your underwriters performed, and also give them an opportunity, based on their performance, to move up in the underwriting pool.

So again, thank you very much. I'm open to any questions that you might have.

MR. CONINE: Thank you, Dale. Any questions? I appreciate your testimony.

MR. LEHMAN: Thank you.

MR. CONINE: Scott Riffle?

MR. RIFFLE: Hello. I'm Scott Riffle from George K. Baum Company in Denver. I too want to just thank the department and the board and all the people in bond finance for allowing us to -- the privilege of serving as both a co-manager, a co-senior, book runner, and some little innovative ideas over the years. We've really enjoyed working with you.

I guess we are comfortable with either option, Option 1 or Option 2. But our firm is here to advocate Option 2. And the purpose of that is that now that the department has decided to go along the track of doing 100 percent SWAP transactions, there is not much of a role for the co-senior or co-manager positions in terms of marketing the bonds. That would be done primarily by the senior manager.

In our firm, all along, regardless of the position we hold in an account, we always think of it as our job to bring innovative ideas to the table. That's just part of being an investment banker and serving the clients. And we'll continue to do that, regardless of what role we serve the department in.

But I think that all of the underwriters that serve you now will be very motivated beyond a book running senior manager, because there really isn't much of a role for them unless they do bring innovative ideas. And that serves our firm very well.

If the market were to change, and obviously it's a dynamic thing, and that SWAPs just don't work anymore, or are not the favored instrument, then the department can look at the situation again, and then advocate putting in firms that sell bonds, and sell them well. And that will also benefit our firm as well.

And so in short, we're here to advocate Option 2. And we're very thankful for the opportunities we've had over the, I guess, the last four or five years, and look forward to the future with the department. Thank you.

MR. CONINE: Scott, what -- let me ask you a question about this SWAP market that you -- based on history, do you feel like it's going to be around for a while? Or go unfavorable with the increased pressure on low -- on the low end of rates -- the short-term rates?

MR. RIFFLE: Well, I mean, everybody has an opinion. And --

MR. CONINE: That's why I asked you.

MR. RIFFLE: -- my crystal ball works only about half the time. But I would say that when I started on Wall Street for Dillon Reed [phonetic], which was about 15 years ago, SWAPs was the vogue thing. And we did a lot of those, and it was an exciting time. And there was a period of time when they went out of favor.

And now, I go to very few meetings where my Wall Street counterparts don't pitch SWAPs and things of that nature. But they are working, and it's a structure that I think provides a lot of benefit, and that's why our firm right now is doing SWAPs, and actually we're keying up one in Ohio now.

So right now, I think that SWAPs provide a lot of value. But the Bond Division does a great job of jumping the hurdles and being prepared for market changes. And I think that two or three years ago, who would have thought that Fannie Mae wouldn't buy bonds on every single deal you bring?

And now we actually had to really work to get them to the table in the last year we did it. So my thought is that there will always be a role for SWAPs, but if the market changes --

MR. CONINE: So you didn't really have to work before? Is that what you're saying?

MR. RIFFLE: I'm sorry?

MR. CONINE: You didn't have to work before? It was really easy? Is that what you're saying?

MR. RIFFLE: No. This -- my job was pretty easy.

MR. CONINE: I wanted to clarify this.

MR. RIFFLE: Yes. My job was pretty easy.

MR. CONINE: Okay.

MR. RIFFLE: But no, I think there will always be a role for SWAPs. And one of the things that's exciting about the SWAP market is that there is no barriers to entry. A firm like ours, I researched it for two years, and I have developed a SWAP test, and started doing them.

We were disappointed that we weren't selected as one of your book runners. And that was largely due to the fact that we performed poorly on the criteria for SWAPs. But you know, that just motivates our firm more, and you know, we'll be there for the next time. But that's half my crystal ball.

MR. CONINE: Any other questions?

MR. RIFFLE: Thank you.

MR. CONINE: Appreciate it. Okay. That's all the public comment that I have. Are you done? I have some more questions if you're done. If you're done, I have some more questions.

MS. CARRINGTON: I might make one comment.

MR. CONINE: Okay.

MS. CARRINGTON: Then I'm done, Mr. Conine.

MR. CONINE: Okay.

MS. CARRINGTON: And that is, Mr. Lehman referred to it. But behind your action -- your board action information, we do have an Exhibit A, which is a proposed qualification summary in the same format as what we used on senior managers. But in this case, there are seven items that we are recommending to be included in those qualifications.

And of course, Mr. Lehman's letter did make some adjustments to the scoring and to some of the criteria.

MR. CONINE: Thanks for teeing up my question, which was to ask Mr. Johnson to come forward and walk us through the chart that I know he spent a lot of time on, and possibly to comment on Mr. Lehman's letter.

MR. JOHNSON: Byron Johnson, Director, Bond Finance. I'll just go item by item.

MR. CONINE: That would be -- however you'd like to do it.

MR. JOHNSON: Net Capital and Excess Net Capital pertain to the financial condition of the firm. The amount of equity available for underwriting transactions -- we felt this was important because, you know, the firms need to be well-capitalized.

In terms of the weighting -- and you'll notice there are individual different weights throughout the grid. We just felt that it was important, but not one of the most important criteria. But that's something definitely we should take a look at.

Number of Total Retail Salespeople and Institutional Municipal Bond Salespeople -- once again, we thought that a firm should have a good presence in the market. We -- this is in consultation with our financial advisor. And we felt that firms should, you know, be able to demonstrate that they've committed resources for the distribution of bonds.

And so we included it, but for TDHCA's specific outlook, we didn't think it was one of the most important criterias.

Item Number 4, TDHCA Distribution Results. This kind of gets to the criteria that Ms. Anderson has promoted, you know, throughout her term on the board. And that's a performance of the firm on our account. And we tried to come up with a quantitative measure, you know, the actual ability or actual performance on the prior deals that they served to the department, whether it was all senior, co-senior, co-manager, we've been tracking that throughout the deal process, and we have that information.

Given the importance of that and relevance of that to TDHCA, we gave that a greater weight. The prior amount of co-senior bonds -- Mr. Lehman mentioned that maybe STC doesn't track it. But I bet if you ask any investment banker what deals they served as co-senior or co-manager on, they can probably recite them off the top of their heads.

So I think it is something that should be considered, in terms of has -- have other entities -- issuers recognized a firm for, you know, whatever purpose, and moved them up in the ranks to a co-senior manager? We included that. We gave it a 5 percent ranking.

Same thing with co-managed bonds. The co-senior role really does -- it is more of a sales and marketing role, and it ties in very -- more closely with the ability to co-manage bonds, as opposed to maybe, you know, senior-managing bonds.

So we included that also. And so item five and six -- once again, we thought they were important and needed to be included but that the department should not focus on them as being the most important criteria.

Item number seven -- innovativeness -- I think number seven and number four really get to the heart of the matter. And that's, you know, if a firm is going to be promoted to a higher level and be given more opportunity for compensation, what have they done to earn that right, and -- you know, as granted by the board?

And the finance team thought that that was a very important criteria. You know, what has that firm done in the past, you know, other than maybe coming and saying you've got a refund, and Well, okay, thank you. We know we got a refunding. But have they brought in an idea that generated, you know, some sort of benefit for the department?

We have had firms that have come in and brought in proposals that didn't work out. We've had firms that have come in and brought in proposals, and resulted in the execution and closing of the transaction. So this would be a means of further rewarding those firms for taking the time to review our indentures, to review our past deals, and come up with ideas.

So you know, in a nutshell, or to summarize, Item four and seven clearly are -- at least from staff and finance team's perspective, the most important criteria. And if we're going to reward firms and award -- allow them to receive additional compensation, then there should be some merit behind it. And that's kind of like being the ideal behind this.

MR. CONINE: A couple of questions --

MR. JOHNSON: Yes, sir.

MR. CONINE: Do you agree with the previous testimony, that in the current SWAP-positive environment, that the role of the co-senior is diminished greatly, and, therefore, may or may not be even needed?

MR. JOHNSON: The -- in the current environment, as with the current transaction, the use of variable rate demand bonds typically requires the use of maybe one senior manager. But what we've done is put together a pool of firms. If this had been a fixed-rate transaction, we would have needed that pool of firms. I would say it does diminish the roles and ability of those firms to participate and sell bonds.

What we've done, and it's kind of a practice -- policy practice by another State Texas agency in the housing/mortgage business, is that we recommend that the liability or the revenues from the transaction be split among the firms participating in accordance with their percentage of liabilities or their percentage of responsibilities for selling bonds.

So although they may not have the possibility of actually getting bonds to sell, they do still participate in the pool and they still do get compensated, you know, in the event that -- they still will get compensated.

But you know, and as we've always said, we're using SWAPs as a temporary measure to try to compensate for market conditions. And when market conditions revert back to higher rates and a greater spread between taxables and tax-exempts, we'll probably go on back to, you know, fixed-rate bonds.

MR. CONINE: How many co-seniors do we currently have today on approval?

MR. JOHNSON: Prior to the selection of the senior managers, we had three. We had the pool of six senior managers and the firms that served as senior managers reverted to co-seniors and back and forth.

So it was really six firms that served as co-seniors, and no more than three at a time.

MR. CONINE: So now that we have three co --

MR. JOHNSON: Three senior managers.

MR. CONINE: -- three seniors, what is bond finance's recommendation on the outcome of this particular selection process in regards to the number of firms?

MR. JOHNSON: We recommend three.

MR. CONINE: Just three?

MR. JOHNSON: Yes.

MR. CONINE: So you end up with three and three?

MR. JOHNSON: Three and three. Yes.

MR. CONINE: Okay. Why did we decide to do differential weighting on this particular selection chart, and straight across-the-board weighting on the senior manager charts? Can you let me know some of the rationale there?

MR. JOHNSON: The senior -- the criteria -- it was more difficult to differentiate between what was more important at that role at that level of performance than at the co-senior role, which we kind of consider the co-senior role as discretionary.

It's more discretionary. It's not really required. So there is less of a thin line between the different variables.

MR. CONINE: You know, I had a little gas about the senior managers being equally weighted, but in the end, the horse race was on. The win, place and show was virtually there. And I didn't want to spend the time necessary to go redistribute the weighting.

But here you've already done it, which I think is important. And I would concur with your decisions. The one I guess I'd like to talk about is the past history with TDHCA, I guess number four?

MR. JOHNSON: Yes.

MR. CONINE: Again, I guess my view differs a little in that you want people around you that have performed in the past, and consistently have the department's interest in their interest.

On the other hand, I think if a firm wants to get into the game, and they meet all the other qualifications, the fact that they haven't been here in the past basically, you know, on this chart, it looks like to me, pretty much rules them out of ever getting in. And so I'd like to hear your comments about that.

MR. JOHNSON: I would respond. That does not rule them out from ever getting in. It is just a matter of time. And -- but they're in the team. They get in to -- rotate onto the team, and they get into the team and they perform, there will be an opportunity for them to rise up.

MR. CONINE: We would have to go -- in theory, we would have to go through this process again --

MR. JOHNSON: Yes, sir.

MR. CONINE: -- to get them to be one of three co-seniors.

MR. JOHNSON: Yes. This is not forever. We will be coming back in a period of time and asking you to review and either rewrite the senior managers, or rewrite the co-seniors and the co-managers. You know, we've had the co-manager pool up and running now for about a year and a half or two.

MR. CONINE: And how big is it? Refresh my memory.

MR. JOHNSON: It's all together 15 firms.

MR. CONINE: Fifteen.

MR. JOHNSON: Right. So I would envision coming back next year saying, you know, this is the way these firms performed. Maybe the bottom firms we need to move up over and let some other firms get in, and see how they perform. It's a long-term approach.

MR. CONINE: Okay. And that's good. That's what we wanted. Do you think 15 co-managers is the right number, based on the experiences you've had here recently of selling bonds? Or can it be smaller?

MR. JOHNSON: Can it be smaller?

MR. CONINE: Should it be smaller? Not can. Should.

MR. JOHNSON: Oh, okay.

MR. CONINE: Or should it be larger?

MR. JOHNSON: That's where I was headed. It could be -- it should -- it could be smaller, could be larger. We -- it's up to -- it's really up to -- we think we're at an optimal point, and we've -- you know, compared to other state agencies, we do issue -- other state agencies in Texas -- there are other firms that have about the same number of firms.

Compared to other state HFAs, we are one of the, I guess, larger firms issuing bonds. So to have a diversity amongst the team and get that nationwide national diversity, I think, helps the department. And I would say a larger team would be -- the smaller team at a larger pool would be better than a smaller pool.

MR. CONINE: You got a question? Go ahead.

MR. BOGANY: Yes, I've got a couple. Byron, in regards to the not having -- well, before I say that, let's go back to the basics. Define to me again, and just help my memory, what a senior manager is going to do, and what the co-manager's jobs do.

I heard Mr. Lehman's thoughts, but I wanted to hear from -- with the new criteria that we've got set up, with a couple that we've chosen, what's the roles of that senior? Because I heard someone say that the senior doesn't do -- the co won't be doing as much marketing as before, and their job is going to be bringing in more ideas and things. So what's that role?

MR. JOHNSON: The senior managers typically structure the cash flow, work on getting the cash flows approved by the rating agencies, pretty much bringing in ideas and work on managing the bond issuance process for the department.

And then their role -- they're the primary firm responsible for the distribution of those securities. And if -- and we are in a bad market, they would be the primary firm that we would look to to underwrite the securities.

So their primary role is to manage the issuance of the bonds and the structuring and creation of the cash flows in the program.

The co-manager is on board to sell bonds. They do not manage the transactions. They do not get involved in the structuring. Their role is to assist the senior manager with the sale of the bonds.

MR. BOGANY: So they're going to be doing the marketing side of the bonds?

MR. JOHNSON: Yes.

MR. BOGANY: Now, how does the agencies -- state agencies that eliminated co-managers altogether --

MR. JOHNSON: Co-senior managers.

MR. BOGANY: Co-senior managers -- who is doing the marketing for them? Does that go back to the senior now?

MR. JOHNSON: Let me go back to the first question. You inquired about senior managers and co-managers. The co-senior manager is in between those two levels. So you have the senior manager, who is running the books, managing the transactions.

You have the co-manager that is assisting with the sale of the bonds. The co-senior manager, which is in between those two levels focuses more on sales than on management and structure.

MR. BOGANY: Okay. So states that have eliminated it altogether -- how do they handle them?

MR. JOHNSON: They have a senior manager and co-managers.

MR. BOGANY: Okay. And the co-managers doing the marketing --

MR. JOHNSON: Think of the co-senior role as kind of a glorified co-manager role.

MR. BOGANY: Okay.

MR. JOHNSON: You've got three levels.

MR. BOGANY: Okay. But do we get innovative ideas -- are the ones that don't have them -- are they getting more innovative ideas and the agencies are making more money just having those two, versus one that we have a co-senior manager?

I guess if I'm going to eliminate on how are those states doing in ideas -- are they making more money than us? Are they having more innovative ideas than we have? And that's what my question would be.

MR. JOHNSON: Right now I can't answer that in terms of are they doing better than us or getting more ideas. I would say that other firms in other states -- is that -- you know, whether they're co-senior or co-manager, or senior managers, do go in and present ideas. This is just the means of rewarding them for keeping our account alive in their analysis.

MR. BOGANY: So let's just say we go and we pick senior, which we have, and a co-senior manager, and then we have a co-manager. Okay. Where are the -- and I'm somewhat concerned of they weigh the ideas at 35 percent with the distribution results, because my thoughts are if I'm new to Texas, I'm coming to Texas and I've been successful everywhere else, I just don't see how I'm going to get into the game to play. It may take me a year to two years to get in the game before I can get in Texas to get done.

And I may have the most innovative idea that is going, but I don't -- I can't get to play, because I don't -- I've never done a project with you guys.

MR. JOHNSON: If you have an innovative idea, and our -- we've always promoted that if a fund comes to us and has an innovative idea, we will bring it to you and get your approval and follow through on it.

So the firm would be able to participate in that manner. They just would not be role -- serving us in the role of a senior -- a co-senior manager. But they will be able to come in, to bring in an idea as they've done in the past, as George K. Baum has done.

We have the Lehman Brothers come in with an idea. Now we have Morgan Keegan coming in with an idea. It's just thinking off the top of my head. I could think of others, but we do give funds the opportunity to be the senior manager on ideas they bring to us if they have the capacity and capability.

MR. BOGANY: My last question -- I guess it's a loaded question, is if you were making this decision, do you feel that we need to eliminate this, or do we go with the same -- do we go with co-senior managers?

I mean, in an ideal world, you know, where everything is rosy, what would be your recommendation, based on you deal with this every day? You know what's going in -- and I guess, do we have a role for some people, just to say we've got a role and they're there? Or do -- are we -- or we set some structure up that's really going to work and benefit this department?

MR. JOHNSON: I would see option 2 as being easier to operate. We would come to the board and say, Firm XYZ did this for the department. They generated, you know, $10, $20, $1,000, $1 million. We were able to use those funds for this program. It's very clear that that fund did something to assist the department.

And it wouldn't be, you know, anything like a Firm XYZ has the best round of golf, or it took us out to the best dinner, or whatever like that. It would be something tangible and evident to the board that that firm deserves to be rewarded for working for the department.

MR. BOGANY: Okay.

MR. JOHNSON: So if you're asking staff, staff would say Option 2, I think.

MR. BOGANY: So you think Option 2 would be -- benefit this department better than Option 1?

MR. JOHNSON: It would be easier to -- it would benefit the department, and it would be easier to implement.

MR. BOGANY: Okay.

MR. CONINE: No further questions, Mr. Johnson.

Thank you.

MR. JOHNSON: Thank you.

MR. CONINE: I'd like to ask our financial advisor a question or two, though. If he could step to the podium. And please sign a witness affirmation form, since I drug you up here.

MR. MACHAK: I'd be happy to, Mr. Chairman. Gary Machak, RBC Dain Rauscher, Financial Advisor, Corporation.

MR. CONINE: Gary, you've participated not only in this process, but in the -- you know, the senior manager process. Can you give us your thoughts on the weighting distribution system within this current outline, and as far as you know, past performance with the agency and innovativeness being, you know, quite subjective, I guess? Tell us your thoughts.

MR. MACHAK: Yes, Mr. Chairman. I think the -- that again, on this process, that Byron's done a great job of kind of slicing it up, getting down to the essence of the different categories. In terms of the weighting, although some may disagree, the innovativeness, I think, is an important part of the transactions that we do.

It's an important part because of the markets are changing very quickly. It's an important part, because that's what's really saving you a lot of dollars on these transactions.

For example, the transaction we're doing today. Though it's corrective, there is not a lot of opportunity for those co-managers to sell the bonds, because it's all going to be done on a short-term basis.

This transaction is going to produce a mortgage loan rate for the citizens of Texas that's going to be 100 to 50 basis points less than they would have if we did the cash market transaction, and there were bonds for those firms to sell and to improve themselves.

So it's a balancing act. I think to some extent, excuse the poor analogy, but it's almost like you have to have a team of underwriters that's almost like a baseball team. You have to have your long relievers, you have to have your short relievers. You have to have your firms here that are retail-oriented. You have to have them that can sell institutional, that have expertise in SWAPs.

You have to draw on those, depending on the market conditions and depending on the type of transaction that you're looking at. So -- but in terms of weighting all those factors, to get back to the essence of your question, I think the innovativeness is the most important, because that -- in -- I think in a measurable way, in the mortgage rate on this transaction, in for instance, producing $1 million for the Bootstrap Program, when you look at what a basis point is on 25 million of bonds, that may be -- expertise in marketing may be able to get you on a sale, that adds up to about $25,000 to maybe $35,000 over the life of the program.

But when you compare that to an idea that someone brings you that produces $1 million in cash today, or saves you 50 basis points to 100 basis points on your mortgage loan, that's a big impact for your operations. So I'm sorry it's long-winded. I'm not sure if I answered the question.

MR. CONINE: No, you did. I appreciate that.

MR. BOGANY: I have a question.

MR. CONINE: Go ahead.

MR. BOGANY: In regards to the -- who is going to be marketing these bonds? Let's just say the -- and Byron may have mentioned it, and it just went over my head. But who is going to be marketing these particular bonds if we did away with the co-senior manager?

MR. MACHAK: If you do way with the co-senior manager, the marketing is essentially going to be the same. It's going to be -- on a transaction like we have being considered today, because it's all short-term bonds, it's basically going to be the senior manager. But everybody on the team is going to participate in that sale.

They are going to get some credit for being part of the team. On your more traditional cash-market structure, the primary people again for marketing it are the senior manager, then would be the co-senior manager, and then the co-managers.

They would all have an equal interest in marketing that, because that's going to be their main source of compensation. If they can outsell what their liability is, or outsell what their participation is, they're going to make more than they expected to make, and it's going to benefit you.

I mean, some of the senior managers is -- what's in the corporate world you may call, like, a special bracket. And special brackets, I think, historically, were put together for large transactions that -- where there were a lot of stocks or bonds to be sold over -- you know, over a long period of time. And so they gave special consideration to certain firms.

There was the managing firms and then there was the special bracket firms, and then all the co-manager firms. To some extent, the size of the transaction determines whether there should be a co-senior or not, much like that special bracket-type concept.

MR. BOGANY: One last question. Being our financial advisor, which one would you recommend to us?

MR. MACHAK: Well, I -- at first I'd say -- I will make a -- tell you what my preference is. But first I'd say I think it's important, as I said earlier, to keep a pool of underwriters that you can utilize and you can draw on their experience for certain situations because of the changing nature of the market.

But given that, I think more emphasis should be placed on the innovativeness, because -- and let me try to -- and say that even a firm that is distribution-oriented and may not say that that should be more important, maybe they are -- at some point in the future they can come up with innovative ideas. But they can also work on the marketing side to bring an innovation to you.

For instance, they can, for instance, pool a bunch of investors together and say, You know what? We can -- if you do a cash-market deal, we can sell these bonds at less than what the market is.

So they're not -- just because you're emphasizing innovation doesn't mean a firm that has the distribution capabilities -- perform on their distribution capabilities, can't bring an innovative idea to you that's' tied to that capacity. And that can save you money.

MR. BOGANY: Okay. So your recommendation is?

MR. MACHAK: My recommendation, my preference would be Option Number Two.

MR. BOGANY: Option Number Two. So it keeps everybody -- it just seems like to me Option Number Two keeps a lot more ideas flowing and --

MR. MACHAK: I think it could -- I think it's a way to keep your -- keep them on their toes, and keep them interested in. And I think it's demonstrated that you'll see cost-saving ideas coming to you, because they know that there is a potential for a reward there.

MR. BOGANY: Okay. A question that Byron couldn't answer, but I know you guys probably represent other state agencies, or at least attempt to. Where do you find in the other state agencies, the ones that are doing -- that's gone with Option 2? Are they benefiting their departments?

Are you seeing those state agencies come out with, you know, great ideas and they're selling their bonds -- they're coming up with things that the public want and the investors want?

MR. MACHAK: That is correct. We -- I think you see the direct results like that, at Texas Veteran's Land Board, at our state, where they have a very similar type structure. And those that bring those ideas are rewarded and able to act on it.

MR. CONINE: You know I -- I guess I'm having some difficulty with Option 2 in the -- from the standpoint of consistency and transparency, because we set the criteria up and went through all the gnashing of teeth for the senior managers. And to be consistent with using this chart that Byron and Staff have developed, to me, is a very transparent and consistent process, albeit we now have different weightings.

But that -- you know, co-senior job is different from a senior job. And I understand, you know, the reasons and rationales behind it. So it seems to me like Option 2 takes us back to the dark ages of you know, we'll just pick one, and no one will know how we got there, and the golf games and the dinners and so forth do contribute to that. And can you respond to that mentality?

MR. MACHAK: I'd -- yes, I'd be happy to respond to it, because I think as a board member, you need to -- you know, that's something that you need to be concerned about.

From my perspective as a financial advisor, and the people that are working day-to-day, it's -- the transparency -- it's -- it is transparent to us. It is transparent to us to see the ideas and who is coming up with the innovativeness.

On the other end, if you feel more comfortable with going with strict criteria that's going to choose your co-senior manager, then that -- there is -- you know, that's a policy decision that is used by other agencies, and I think will work fine for us.

MR. CONINE: I -- given the board's continued, I guess, discretion to continue that it -- if something innovative comes out of the park, and one of the six firms we have is either senior or co-senior, isn't the one that brought it to the table, you know, we can always make exceptions to the rule for a particular firm who -- at least in my mind, we can make sure we have the discretion to be able to allow that to continue to bubble up while on the, say, standard mortgage revenue bond issuance -- if we ever get back to a day of standards -- we would have the team and the transparency and the selection already set. And as I -- I'm a little more comfortable as a board member.

MR. MACHAK: Well, I think I see what -- yes, I'm -- sort of a middle ground here, or maybe a hybrid between the two, because certainly you can say, okay, let's choose three co-senior managers. But let's not leave out the innovativeness. And let's say that anybody from your co-manager team that comes up with an innovation can also be placed on a future transaction as a co-senior manager.

So maybe there is a -- you know, there is a -- it just isn't an either/or. There may be a hybrid option that we can construct and satisfy all your concerns.

MR. CONINE: Well, we can -- I don't think this meeting is the meeting to do that. It will be at the next meeting when we decide really what we're going to do, assuming we run them through the filter.

But I appreciate your thought. I don't have any more questions.

MR. BOGANY: I have -- I just have one more. So my firm was not one of the three that was chosen over how many it is, and I came up with the innovative idea, how do I get it in play? I don't meet the distribution list, but I've surely got 40 percent of innovativeness.

MR. MACHAK: Right.

MR. BOGANY: So how do I get my deal to you guys? Do I have to go through one of your senior -- your co-seniors or co-managers to get my idea to a buyer? How does that work?

MR. MACHAK: You would not -- I suspect you would not have to go to a co-senior or a senior to get that idea. I mean, we're always open, no matter where they come from --

MR. BOGANY: Okay.

MR. CONINE: -- to innovative ideas. And it would just have to be in the -- you know, in the policy of the board that if someone came up with an innovative idea that put, you know, half a million to two million, for example, or came up with some way to lower your mortgage loan rate, that they then can participate as a co-senior manager on a transaction, you know, in the future.

Now, they still probably -- depending on how you constructed it, they still probably wouldn't be part of the three members that were permanently put as -- well, not permanently, but in this phase, put as senior managers, but they could be elevated because of that innovativeness.

MR. BOGANY: Okay. So they could go in -- are they forced to work with the senior managers and the co-managers that we have? So now we've got a senior manager and a co-manager that didn't come up with any idea, and they'll now come up with an idea now, and we've got to cut all those -- those two people in also.

I'm just trying to figure out how this works.

MR. CONINE: I think what I heard Gary advocating is the board maybe develop a way to let them in later on, if it was their idea. And if Ford has a better idea, let them in, let them play at either the co-senior or senior position, if and only if they met the qualifications that a firm has to meet to play in either one of those spots. But --

MR. MACHAK: The way this group would, on a transaction, would be constructed, for instance, would be you'd have one senior manager, one co-manager, and maybe -- I'm sorry, one co-senior manager, and maybe three or four co-managers.

One possible way of doing that would be to say this firm came up with an innovative idea. It put money in our pocket that we're utilizing in an important area. And the three co-seniors are going to have to weigh the transaction. We're going to put this firm in as a co-senior on this transaction. We're going to reward them for that.

MR. BOGANY: I'm -- yes, that's what I'm -- you know, I want to reward somebody who has come up with innovative ideas. So I guess a hybrid. And I do understand Mr. Conine's point wholeheartedly. But in this job I've learned I don't think everything is set, you know. Things that should be are not really what they are.

And so -- and I think some hybrid or cross-section would probably be the best way, because I do understand his point.

MR. MACHAK: Uh-huh. And I'd -- that's an important point. I couldn't -- from your position, those are strong considerations, and I agree with those.

MR. BOGANY: Thank you.

MR. CONINE: Any other comments or questions? Do I hear a motion?

MR. BOGANY: That's it. My motion for adjournment.

MR. CONINE: No, no, no. No, no, no. We've got a few other things to do. I was thinking that maybe we would, as a Finance Committee, recommend to the board that we consider doing one or the other.

I'll make the motion that the Finance Committee recommends Option 1, with the additional caveat, if you will, of looking at the ability to insert a firm for innovativeness and creativity into the process after we make the selection at our next meeting, or whenever it happens to be.

MR. BOGANY: So moved. Second.

MR. CONINE: Second. All in favor, say aye.

(A chorus of ayes.)

MR. CONINE: All opposed? The motion carries.

MS. CARRINGTON: Clarification, Mr. Chair.

MR. CONINE: Uh-huh.

MS. CARRINGTON: Exhibit A --

MR. CONINE: Uh-huh.

MS. CARRINGTON: Would that be with the seven criteria that we have listed with the scoring of the weighting that we have listed also?

MR. CONINE: Yes.

MS. CARRINGTON: Thank you.

MR. CONINE: We did not make any changes there.

MS. CARRINGTON: Thank you.

MR. CONINE: Okay. Item 3, Presentation, Discussion and Possible Approval of Program Modifications for 2004 Series A and 2004 Series B. Ms. Carrington?

MS. CARRINGTON: Thank you, Mr. Chair. We are asking for approval of restructuring a single-family program. It was the 2004 Series A and 2004 Series B

Program, Program 61.

We issued these bonds with an amount of down payment assistance. So some of our mortgages were assisted with down payment assistance. Some were not assisted with downpayment assistance. And we have basically -- our lenders have originated the non-targeted unassisted funds.

But we have a chunk of about 80 million that has still not been originated. And of course, the mortgage loan is higher because it includes the amount of downpayment assistance.

So actually, that dollar figure that has not been originated on the assisted, both in targeted and non-targeted is $80,909,057. And what we would be proposing is that we take the amount that would be going in for the downpayment assistance, and that we actually take those dollars and buy down the interest rate down to 4.99.

So there is actually no additional money that's being put in the program. It is just utilizing the amount of downpayment assistance to make these zero-point mortgage loans.

MR. CONINE: Questions?

MR. BOGANY: I have a question, Ms. Carrington.

MS. CARRINGTON: Yes, sir.

MR. BOGANY: And so I've read this, and I'm a little slow today. But understanding that there would be no downpayment assistance, but the interest rate would be 4.99 -- is that what we're doing?

MS. CARRINGTON: That -- this is not correct, according to Mr. Johnson.

MR. JOHNSON: The -- there'll be no downpayment assistance. And the interest rate will be 5.5. There will be zero points to the borrower.

MR. BOGANY: So the borrower would actually -- could get in here with zero points, or have to pay a loan origination or participation figure --

MR. JOHNSON: Correct. There will be no discount fee or origination points to the borrower.

MR. BOGANY: What's the median income -- what's the income median for this particular program?

MR. JOHNSON: For the next 30 days or so, it will be 60 percent as required by state law. And then after, I think, it's May 1, it will be open to up to 115 percent.

MR. BOGANY: Okay. So the person would get 4.99 --

MR. JOHNSON: No, 5.5.

MR. BOGANY: -- 5.5 with no assistance?

MR. JOHNSON: Correct.

MR. BOGANY: Okay. But it doesn't cost them anything to get into the program?

MR. JOHNSON: Correct.

MS. CARRINGTON: And it doesn't cost us anything to restructure.

MR. BOGANY: Okay. So moved.

MR. CONINE: Motion made to recommend to the board approval of this modification. I'll second. Any further discussion? Seeing none, all those in favor, say aye.

(A chorus of ayes.)

MR. CONINE: All opposed?

(No response.)

MR. CONINE: Motion carries. Item 4 --

MS. CARRINGTON: For the record, Resolution Number 05-024.

MR. CONINE: Thank you, Ms. Carrington. Item number four, Presentation and Possible Approval of Single Family Mortgage Revenue Bonds, 2005 Series A (Variable Rate) for Program 62. Ms. Carrington?

MS. CARRINGTON: Thank you. This is our new single family program for 2005. And what we are proposing is the refunding of convertible option bonds in the amount of 88 million, and also a refunding of commercial paper that would provide a total of 100 million in this transaction.

It is going to be 100 percent variable rate demand bonds. The two SWAPs that the agency has done in the past -- I believe the first one was 30 percent of the transaction. And the fourth SWAP was -- the second SWAP was 40 percent of the transaction.

So this is the first time that we are proposing a SWAP that would be for 100 percent of the transaction. And we are targeting, but since we are going to be using 100 percent of variable rate demand bonds that are interest rates on this particular program, we're targeting between 4.99 and 5.4.

We did provide you some information on the second page of the write-up. It said if we were not using this type of derivative product, that our interest rates would be, we believe, somewhere in the 6-point to 6.25 percent range.

The team for this particular financing is Bear, Stearns, who is the senior manager on this particular transaction, and also the SWAP provider. And George K. Baum is serving as co-senior manager. And then on page 3, we also have Bank of America Securities, Loop Capital, Merrill Lynch and Morgan Keegan.

And below that is a schedule for this particular transaction. Obviously bond finance and the agency and our professionals have been working on this for several months. And we are hoping to receive approval from the board today. And we have already been to the Bond Review Board. Our pricing windows are in the next week or so.

MR. JOHNSON: Yes.

MS. CARRINGTON: And looking at our pre-closing sometime the 19th, 20th part of April. The last page for your information is some supplemental information on what the department does still have out there right now in mortgage money that's available, because we do still have some money in other programs. And we have told you the rate and how much we actually have out there that is uncommitted at this point.

MR. BOGANY: So the interest rates that are in the book of just what the variable -- what it may be between that rate? Am I correct?

MR. JOHNSON: Yes, sir.

MR. BOGANY: Now, is down payment assistance included in this one too?

MR. JOHNSON: No down payment assistance on this program.

MR. BOGANY: This is just strictly --

MR. JOHNSON: Unassisted.

MS. CARRINGTON: Unassisted.

MR. BOGANY: Unassisted.

MR. JOHNSON: We're -- ideally -- I'm sorry. We're trying to target sub-five. And it's become a little bit more difficult, given the increase in the rates, even with the SWAP. So we may combine the SWAP with some of our zero percent money to produce the 4.99 rate. If we do that, we feel there will be no problem in originating the funds.

And this program, in combination with the program you just approved the restructuring, will give us two offerings for borrowers, a zero-point offering, and a very low rate with two points.

MR. BOGANY: Okay. So they have an option which one to go to?

MR. JOHNSON: Yes.

MR. BOGANY: Okay. So there won't be any down payment assistance at all?

MR. JOHNSON: Not on this program.

MR. BOGANY: Okay.

MR. JOHNSON: If -- in the supplemental

information, Program 59-A, the 15 million that's unallocated is assisted, and it's 5.99 or four points of assistance. So there is some assistance there for folks who want to receive down payment assistance.

MR. BOGANY: What's the median income on that?

MR. JOHNSON: Up to 80 percent.

MR. BOGANY: Up to 80 percent. We can't go higher than that? That's the state?

MR. JOHNSON: Well, we have the option to go higher. We just didn't know if that would -- I guess the department's experience has been that providing down payment assistance to the AMFIs higher than 80 percent has been not well-received, maybe.

MR. BOGANY: But you're not using any of the money that we've got. We just restructured some to add down payment assistance. And nobody is using it. That's why we're restructuring it.

And it seems to me that when you get into the 60 to 80 percent price range of that person qualifying for a home, he's not going to be able to qualify for a home anyway at that income, even with our assistance, because the prices of homes have gone up.

And so it seems like we need to switch or change or do something a little bit different to try to push this product through and get it out so we're --

MR. JOHNSON: Yes, sir. I'm sorry? If the board is willing to approve us going up, you know, to higher AMFIs with the assistance, we'll present that to you. But at this point, we've never presented anything higher than 80 percent to the board.

MR. BOGANY: Well, yes. That would be my thought. We've been doing it the way we've been doing it, and not originating any money. And I do believe this has to do with the 80 percent limit. Because unless you're going into deep South Texas or deep West Texas, a lot of times, you're not going to be -- you're going to need more income than that to qualify for a home with higher taxes, higher insurance, that the homeowner is having to look at.

And I just think we ought to raise it from 80 percent. Maybe 100 percent or something. Just something a little bit closer, because if you take that 80 percent homebuyer, he can't really qualify for a house a lot of times pricing-wise.

MR. CONINE: And maybe we can ask our -- I can't think of the word, for the research -- the Center for Research. What is the name of it?

MS. CARRINGTON: Policy and Public Affairs.

MR. CONINE: Thank you. Thank you very much.

To give us a little white paper on the possibility of raising that up, and what markets it really hits, and what markets it missed, and what the median income, median price -- home price is in those respective maybe 13 state service regions.

You know, rather than just grabbing it out of mid-air, we can ask for some input on that one. And we can always modify this stuff, you know, so we can move forward.

MR. BOGANY: Well, I truly would like to see us relook at it, if that's what it takes on it, because I'm out here, and I'm telling you, if you had $30,000 worth of income, and you can be single and you've got a car note of $300 or $400, you cannot qualify for a home.

And then if you go and say, Well, I'll buy a condo, then you've got a maintenance fee of $200. And that throws you right back out the deal again.

And I just -- we just haven't been able to originate any of this money. And so let's take a look at it and see if we can do better.

MR. JOHNSON: Yes, sir.

MR. CONINE: Why don't you put that on the agenda to report back the next meeting.

MS. CARRINGTON: Yes, sir.

MR. CONINE: Do I hear a motion to approve -- or recommend?

MR. BOGANY: So moved.

MR. CONINE: And I'll second it.

MS. CARRINGTON: Resolution number 05-021.

MR. CONINE: All those in favor, signify by saying aye.

(A chorus of ayes.)

MR. CONINE: All opposed?

(No response.)

MR. CONINE: Motion carries. I might parenthetically say, looking at the supplemental information, Program 56 needs some innovativeness. It's sitting there with $125 million sitting there at six-and-a-quarter. We need some innovativeness there. So --

I have nothing else on the Finance Committee agenda. Any other issues from anybody?

MS. CARRINGTON: Mr. Johnson?

MR. JOHNSON: We do have -- we do need to substitute the resolution. And the resolution that's in the book now, we did not include the co-senior manager, and here we have it. But we'll take care of that with Delores. But I just wanted to bring it to your attention.

The only thing that's different is Exhibit A, which listed the naming of the firms.

MR. CONINE: It's the same resolution number, but a different sheet.

MR. JOHNSON: Yes.

MR. CONINE: We can do that at the board meeting.

MR. JOHNSON: Okay.

MR. CONINE: Okay. The Finance Committee stands adjourned.

(Whereupon, at 11:08 a.m., the meeting was concluded.)

C E R T I F I C A T E

MEETING OF: TDHCA Finance Committee

LOCATION: Austin, Texas

DATE: April 7, 2005

I do hereby certify that the foregoing pages, numbers 1 through 58, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Penny Bynum before the Texas Department of Housing and Community Affairs.

04/15/2005

(Transcriber) (Date)

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